UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

OHIO PUBLIC EMPLOYEES RETIREMENT SYSTEM, on behalf of itself and all others similarly situated,	)	**Case No. 4:08-cv-160**
	)	**Youngstown, Ohio**
	)	**Wednesday, June 11, 2014**
	)	**2:22 p.m.**
Plaintiffs,	)	
vs.	)	
FEDERAL HOME LOAN MORTGAGE CORPORATION, aka FREDDIE MAC, et al.,	)	
Defendants.	)	

TRANSCRIPT OF PROCEEDINGS
BEFORE THE HONORABLE BENITA Y. PEARSON
UNITED STATES DISTRICT JUDGE

ORAL ARGUMENT

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P R O C E E D I N G S

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LAW CLERK: The matter before the court is Case Number 4:08-cv-160, Ohio Public Employees Retirement System versus Federal Home Loan Mortgage Corporation.

14:26:13

THE COURT: Good afternoon, everyone. You may retake your seats.

Thank you for joining me here this afternoon to hear oral argument and defendants' renewed motions to dismiss plaintiffs' third amended complaint.

14:26:23

I have what I believe is a comprehensive list of counsel who are present, but I will still ask if you'll take a moment to introduce yourselves so that the record correctly reflects those who are present. I will start with plaintiffs' counsel.

14:26:44

Will one of you volunteer to introduce all of you or each of you rise and introduce yourselves?

MR. STOCK: Your Honor, I'll volunteer. My name is Chris Stock, Markovits, Stock & DeMarco, on behalf of the plaintiff.

14:26:57

And with me today is Kevin Lewis, our technician; Mr. Rick Wayne; Dylan Gould, that's G-o-u-l-d, who is an intern with us; and Mr. Bill Markovits, who is also of Markovits, Stock & DeMarco. Thank you.

14:27:12

THE COURT: Thank you, Mr. Stock.

On behalf of the defendants, Freddie Mac as well as the individual defendants, I would appreciate it if you would introduce yourselves, or if one of you is capable, to introduce all of you. A heavy task, I know, but I'll allow you to decide.

14:27:27

Mr. Hershman, will you begin?

MR. HERSHMAN: I think I'll beg off, Your Honor.

THE COURT: But at least introduce yourself.

MR. HERSHMAN: Yes. Jordan Hershman of Bingham McCutchen for Freddie Mac, and with me is Jason Frank of Bingham McCutchen for Freddie Mac.

14:27:38

MR. FRANK: Good morning, Your Honor. And with us from Freddie Mac is Barry Parsons.

MR. PARSONS: Good morning, Your Honor, or afternoon.

14:27:52

THE COURT: Good afternoon. Welcome to you all. Next then.

MR. PARSONS: Thank you, Your Honor.

THE COURT: Certainly.

MR. DOLUISIO: Michael Doluisio from Dechert on behalf of Eugene McQuade.

14:27:54

THE COURT: Thank you. Anyone with you, sir?

MR. DOLUISIO: No, Your Honor.

THE COURT: Okay. Fantastic.

MR. GOLDFARB: Hi. I'm James Goldfarb, Your

14:28:04

Honor. Good afternoon. I'm with Murphy McGonigle, and we represent Defendant Anthony Piszel. Also, local counsel for both of our clients is here, Joe Weinstein from Squire Sanders Patton?

14:28:18 MR. WEINSTEIN: Squire Patton Boggs.

MR. GOLDFARB: Squire Patton Boggs.

THE COURT: Welcome.

Mr. Kravitz?

MR. KRAVITZ: Yes. Carl Kravitz for Patty Cook, 14:28:27 from Zuckerman Spaeder. Caroline Reynolds is here with me.

THE COURT: Welcome.

MR. McKAY: Your Honor, Hugh McKay, also local for Freddie Mac.

THE COURT: Welcome, Mr. McKay.

14:28:39 MR. VOLPE: Good afternoon, Your Honor. Frank Volpe from Sidley Austin on behalf of Richard Syron.

THE COURT: Thank you. And I think that means that all of you have been introduced. Am I correct on that?

UNIDENTIFIED SPEAKER: Yes.

14:28:50 THE COURT: Now, Counsel, as you know from my modified or second order spreading out the protocol, the individual defendants will have 30 minutes of my time. If I interrupt you, I'll try to balance it out by giving you a little more time, if you need it. Freddie Mac, you'll have 14:29:07 30 minutes. And those are for your initial arguments.

Plaintiff, if you care to use it, I'll give you up to an hour. Use what you need. If it's up to the 60 minutes, you have it.

Defendants collectively, I'm permitting you 15 minutes for rebuttal.

Before you begin, Defendants, and I assume that you've already decided how you'll start, which one of you will speak first, I want to inform you that I have a jury in residence. The jury -- at least the attorneys for the case know that this matter takes precedence over that, at least for now. If there is something that can wait, such as a verdict, it shall wait. But if there is something urgent, I might have to turn my attention to that. So I explain that to you now just so that you'll understand.

With that, for the defense, are you prepared to start?

MR. HERSHMAN: We are, Your Honor.

THE COURT: Will you tell me what you have in mind in terms of how you'll proceed?

MR. HERSHMAN: Your Honor, Freddie Mac will go first. Defendant Syron has ceded his time to Freddie Mac, so I will be -- with the leave of court, I will be going for the first 37 1/2 minutes. After me -- and, by the way, thank you very much, Your Honor, for granting us the extra time that we requested. We greatly appreciate it.

MR. KRAVITZ: I am Carl Kravitz here. I am going to go second for Patty Cook.

THE COURT: Thank you.

MR. GOLDFARB: Your Honor, James Goldfarb for Mr. Piszel. I will speak after Carl.

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MR. DOLUISIO: And, Your Honor, Michael Doluisio. I will speak last, on behalf of Mr. McQuade.

THE COURT: Okay. And that's in the opening presentation, you're not speaking about rebuttal?

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MR. DOLUISIO: Correct, Your Honor.

THE COURT: Understood. And all I'll ask is that when you do present, if you'll do it from the podium. Because you've appropriately shared that table, some of you don't have microphones, and it will just be best if all of you speak from the microphone.

14:31:07

Plaintiffs' counsel, sometimes your view of me will be blocked. Not a big deal to me. I'm not really expressive. But if it matters to you, you can move around to a place where you have a better vantage point.

14:31:23

MR. STOCK: Thank you, Your Honor.

THE COURT: Absolutely. When you're ready.

MR. HERSHMAN: Your Honor, may I -- as I was here last time, I have some demonstratives that I used like last time, and I'll set them up over there as I did last time and project from there. I have copies for everyone. And I have

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a handout for the court as well.

THE COURT: Will you hand --

MR. HERSHMAN: Thank you, Your Honor.

THE COURT: Do you have enough to give us each one?

14:31:52

MR. HERSHMAN: I absolutely do, Your Honor.

THE COURT: Thank you. I'd appreciate it.

MR. HERSHMAN: And more if you need.

THE COURT: I have a few interns here. Maybe you can leave extras. But for now I think we're fine.

14:31:59

MR. HERSHMAN: We have a few extras, that would be fine.

THE COURT: Okay.

MR. HERSHMAN: Your Honor?

THE COURT: Yes, you may begin, sir. Thank you.

14:32:17

MR. HERSHMAN: I'd like to start off by addressing the issue of loss causation, Your Honor. We think it's dispositive in this case. And what I am going to do is focus on the leading Sixth Circuit cases, as we are relying on Sixth Circuit cases to support our motion.

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Those Sixth Circuit cases require that a plaintiff allege the existence of a corrective disclosure that revealed the alleged fraud.

I am going to be talking about the Omnicare case and the D.E.&J. case in particular, Sixth Circuit cases.

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Now, you have asked for us to address the issue of a materialization of the risk theory of loss causation, which I will do throughout. And in particular, I am going to focus on the case called Almost Family, which specifically analyzes every sort of approach of this materialization of the risk theory that the plaintiff is relying upon here and rejected it, focusing upon the very same case that the plaintiff is relying upon, Lentell versus Merrill Lynch, and I'll talk about that.

14:33:23 As to all of these cases, we rely upon them in our moving brief. The plaintiffs have no answer to any of these cases. They don't even cite these cases. They say nothing about these cases in their opposition brief. These are the leading cases.

14:33:44 I am going to start out first by focusing on the Omnicare case.

Excuse me one second, Your Honor.

THE COURT: Mr. CSO, if you want to move your chair back so you can read those, then you are welcome to do so.

CSO: Get out of the line of fire.

MR. HERSHMAN: Your Honor, from a big picture standpoint, I am going to focus on a few of these leading cases, and then I am going to show how this law applies to the facts here.

The first case I'm going to focus on is the Omnicare case. In the Omnicare case, the Sixth Circuit was looking at a number of specific types of alleged misrepresentations. Some involved Medicare Part D. Some of them involved revenue calculations.

14:34:25

On the Medicare Part D allegations, the CEO stated -- this is the alleged misrepresentation -- "We are pretty confident that we are not going to be hurt by moving into the Part D structure."

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During the class period, there was an article that came out that discussed "struggles to overcome major glitches associated with new Medicare Part D drug program."

Nonetheless, the Sixth Circuit held that this did not plead loss causation under Sixth Circuit law, stating

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"The complaint 'failed to explain how the statements were revealed to be false and thereby caused the stock drop.'"

Under Sixth Circuit law, the disclosure, the event, the loss cause and event must reveal the falsity of the challenged statements under Sixth Circuit law. This is

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Omnicare, the leading Sixth Circuit controlling case.

Now, there are also GAAP allegations. The Sixth Circuit also held loss causation was not pled: "Complaint nowhere suggests how or when any of these alleged accounting improprieties were disclosed." The falsity of the

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challenged statements, the falsity of the accounting issues

had to have been revealed, had to have been disclosed. It wasn't. No loss causation.

Now, the Sixth Circuit also rejected the argument that the GAAP allegations "were implicitly disclosed because Omnicare's allegedly illegal conduct translated into the accounting violations."

That's not good enough. The Sixth Circuit itself holds, "No, no, it's not that it's implicitly disclosed, it has to be that the falsity, the corrective disclosure reveals the falsity of the challenged statement."

Now, the next case that I am going to focus on is the D.E.&J. case. This is also a Sixth Circuit case on loss causation. It gets cited very frequently. It also self-discusses the Lentell case on which the plaintiffs rely.

The allegations supporting loss causation in D.E.&J. are, frankly, far stronger than those that are at issue in this case. Why do I say that?

In that case, the allegation was the fraud was disclosed in connection with the following events and revelations: Kmart went bankrupt. It triggered a 60 percent drop in its stock price.

In this case, we don't have a bankruptcy, we simply have Freddie Mac announcing a quarterly loss. In this case, Freddie Mac's stock price dropped 29 percent, not

the 60 percent in this case, in D.E.&J.

Also, Kmart received a whistleblower letter alleging that there was an accounting scheme, a fraudulent accounting scheme involving the president and COO.

14:37:35 There were statements by former Kmart employees and vendors that allegedly supported these accounting fraud allegations.

And Kmart subsequently announced a $2.42 billion loss, a restatement of its financial results, and another

14:37:52 $1.45 billion loss.

Those are the facts in that case.

Now, here's what the Sixth Circuit ruled: None of that established sufficient pleading of loss causation. It affirmed the grant of motion to dismiss on loss causation

14:38:14 grounds. It said the stock drop 60 percent, the bankruptcy, the restatement, the many billions of dollars in losses, more than that that occurred in this case, none of them establish loss causation under Sixth Circuit law.

"The observation that a stock price dropped on a

14:38:32 particular day, whether as a result of a bankruptcy or not, is not the same as alleging that a defendant's fraud caused the loss."

And then the court concluded, and this is a quote: "Absent facts establishing a causal connection between the

14:38:49 plaintiff's loss and the alleged misrepresentation: The

securities laws would become nothing more than 'a partial downside insurance policy.'"

And that's an internal quote by the Sixth Circuit to the Supreme Court's ruling in the Dura case, which is the controlling Supreme Court case on loss causation.

Now, I just want to focus on just a few more details in the D.E.&J. case that are worth pointing out. In the ruling at 133 Federal Appendix at page 1000, the court says the following in D.E.&J.: "As to the bankruptcy filing, D.E.&J.," meaning the plaintiff, "never alleged that Kmart's bankruptcy announcement disclosed any prior misrepresentations to the market."

So, again, the focus was by the Sixth Circuit. There has to be a revelation of the falsity of the prior alleged misrepresentation.

And, the Sixth Circuit discusses the Lentell case, on which plaintiffs rely. In the glossary that they submitted to you, their definition of "materialization of the risk" is literally from the Lentell case in the Second Circuit. And in D.E.&J., the Sixth Circuit cites Lentell and states the following in its own parenthetical.

And let me just tell you very briefly, Lentell involves Merrill Lynch analysts putting out very positive analyst reports on Internet companies, supposedly not believing them to be true, that artificially inflated the

value of these companies, and then it came out that they didn't believe that they were true.

And in Lentell, the Second Circuit holds loss causation was not established in the Lentell case on which the plaintiff relies.

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And here's what the Sixth Circuit says about Lentell. It describes it as follows: "Explaining that Defendant Merrill Lynch's downgrade in its stock recommendations from 'accumulate' to 'neutral' and from 'buy' to 'accumulate'" -- meaning that the alleged corrective disclosures, the point at which Merrill Lynch started downgrading the stocks and that was the alleged corrective disclosure -- "did not amount to a corrective disclosure," this is quoting Lentell itself, "because they do not reveal to the market the falsity of the prior recommendations."

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So that's the actual Second Circuit law from Lentell. It has to be that the corrective disclosure, that the event that ends the class period reveals the falsity of the challenged statements.

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Now, the last of the cases that I'm going to focus upon right now on loss causation is this Almost Famous case. And that's because in this case, the court looked at this exact argument that the plaintiffs make here, this sort of what I'll -- I'll call, frankly, a bit of a

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misinterpretation of Second Circuit law. Because the Sixth Circuit has no acceptance of this theory. And this issue is looked at in this particular case, which is a district court in the Sixth Circuit.

14:41:58 And it rejects as inconsistent with D.E.&J., the Sixth Circuit case I just showed you, the argument that loss causation may be established by alleging "materialization of a risk that was concealed by fraud."

And then the court went on to explain, "Under 14:42:18 Sixth Circuit law, a plaintiff 'must show some revelation of the defendants' fraud,' which 'must amount to more than revelations of possible risks'" -- the emphasis was in the original there -- "that defendants engaged in fraud."

And then the court goes on to further explain, "If 14:42:40 the purpose of the loss causation requirement is to ensure that an investor's loss is actually caused by a defendant's fraud, and not by an unrelated circumstance in the market, then a plaintiff cannot satisfy her pleading requirements while the fraud remains concealed from the market.

14:42:56 "Stated another way, the market cannot respond to fraud until it has been revealed."

Now --

THE COURT: Do you want to help him with that?

MR. HERSHMAN: And just a few other things I'd 14:43:13 like to point out about this Almost Family case. Almost

Family looks specifically at the Lentell case, analyzes the Lentell case that the plaintiff relies upon, has a very lengthy footnote doing that, Footnote 6, in the case.

And what they say in there, among other things, is as follows: "The court has carefully considered Lentell and is satisfied that the Second Circuit seemingly recognizes that, at the very least, fraud must be uncovered and responded to by the market before loss causation can be established."

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And then they go on to say, the Second Circuit, quote -- the Second Circuit's analysis "appears to contemporaneously contemplate that such misstatements must be revealed to and responded to by the market before loss causation can be established."

So this is their analysis of Lentell.

Also in Almost Family, the court looks at the D.E.&J. case, which is not surprising, as that's a Sixth Circuit case and this is a district court in the Sixth Circuit, and they say about D.E.&J., that "Relying on the loss causation analysis set forth in Dura Pharmaceuticals," which is the Supreme Court case on loss causation, "the court concluded that the plaintiffs had," and now this is quoting D.E.&J., "done nothing more than note that a stock price dropped after a bankruptcy announcement, never alleging that the market acknowledgement of prior

misrepresentations caused the loss." There has to be an acknowledgement that the prior statements were false.

And then they go on to say, quote -- this is summing up their whole analysis of the materialization of the risk issue. They conclude as follows in that case: "Relying on the circuit court analyses," including Lentell and D.E.&J., "this court concludes that plaintiffs must show some revelation of defendants' fraud."

And then they go on to say, "In order to satisfy the pleading requirements of loss causation, the disclosures must amount to more than revelations of possible risks," emphasis in the original, "possible risks that defendants were engaged in such prohibited practices."

And now, now I want to apply this law to the facts of this case. In this case, there is only one alleged corrective disclosure, and that is Freddie Mac's November 20, 2007 press release, which announced that Freddie Mac had incurred a loss in the third quarter of 2007.

THE COURT: Now, let me interrupt you for the first time to help you clarify a point for me.

There is, of course, referenced in the third amended complaint, and I think it's at paragraph 190, the November 20th, 2007 press release. There is no attachment, so I don't -- to the third amended complaint of the press release.

MR. HERSHMAN: Okay.

THE COURT: So I'm left looking to what the defendants have suggested was produced by Freddie Mac on that date as the press release, and I have been given two different documents, I believe.

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One came from Freddie Mac. It's filed at ECF Number 298 as Attachment 42. The other is attached to Ms. Cook's motion to dismiss, and it's filed at ECF 290, at Attachment Number 22. One is 109 pages long; one is 50 pages long.

14:47:02

So at an initial point, it would be helpful to me to know exactly what it is when you say "the November 20th, 2007 press release." Do you have that? Can you point to me what that singular document is? Because it's not attached to the complaint, and at least two defendants have suggested two different documents as being that.

14:47:17

Can you help?

MR. HERSHMAN: Yeah. I guess what I would say, Your Honor, is the following. There are two things I would say. One is, I'll do the best that I can to get you that press release. And I don't know whether literally in this second in the middle of the argument that I can produce it to you, but we certainly will get it to you.

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THE COURT: What you can do, if not present the physical item, which would have been beyond my hope, make

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sure that I know what you're talking about when you speak about the November 20th, 2007 press release. And then at some point, if not before we separate, soon after, you'll give me what it is you're referring to.

14:48:01 MR. HERSHMAN: Okay. I will do that, Your Honor, and I am sorry for any confusion.

THE COURT: Well, that's why we're here, to clear up confusion.

MR. HERSHMAN: But this much I will tell you, Your

14:48:10 Honor: Whether it's a shorter version or a longer version of the press release, there is nothing in the complaint and nothing in the press release to show that any version of a press release issued by Freddie Mac on November 20th, 2007, revealed the falsity of any prior statement that Freddie Mac

14:48:34 made regarding subprime loans, Alt-A exposure, capital adequacy, underwriting or internal controls. There is nothing in that disclosure that reveals the falsity of any prior challenged statement by Freddie Mac on any of those subjects.

14:48:51 And if the court compares either version, but I will resolve any of those issues -- yeah. I mean, the press release itself I think is three pages. I think there are exhibits that you may be referring to, but I am going to get to the bottom of that and sort it out.

14:49:07 But having said that, if the court compares the

alleged corrective disclosure in this case, and that's only things that came out November 20th, 2007, the end of the class period, to the challenged corrective disclosures, in the Sixth Circuit's rulings in Omnicare, in D.E.&J., in the cases applying them, Eaton Corp and Almost Family, there is no way that under Sixth Circuit law, we believe there can be a conclusion that anything Freddie Mac issued on November 20th, 2007 constitutes a corrective disclosure within the meaning of controlling Sixth Circuit law.

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And, therefore, it's like in the Omnicare case, where OPERS' allegation that the press release -- here, OPERS' allegation that the press release constitutes a corrective disclosure improperly "rests entirely on speculation." That's quoting the Sixth Circuit rejecting the argument that in that case, the corrective disclosure was a corrective disclosure. They said, "No, no, that's just purely speculation for you to say that this is actually revealing a prior fraud. It doesn't do that."

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Now, I now want to focus, in particular, on the plaintiffs' allegation as they relate to the quantity of subprime loans in Freddie Mac's guarantee portfolio and how that ties to the loss causation argument.

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Now, I am going to jump to the chase first, and then I am going to back it up. Here's the chase: From a law standpoint, they're relying on Second Circuit law. They

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don't even cite Omnicare and D.E.&J., which is the Sixth Circuit law.

And, they make the same allegations, literally identically the same on this issue as are in the Central States case, where the Second Circuit itself applied Second Circuit law, applied, literally, Lentell, to literally these exact same factual allegations. Not similar ones, the exact same factual allegations.

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And the Second Circuit concluded, in applying Second Circuit law, which isn't really what applies here, that plaintiff there failed to plead loss causation under Lentell and the Second Circuit law. And so there's no way that the plaintiffs here can plead loss causation as to these allegations consistent with Second Circuit law, because that is what was applied in Central States.

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Now, why do I say these things? According to OPERS, Freddie Mac disclosed that as of the second quarter of 2007, "only a tenth of 1 percent of its single family guarantee portfolio was classified as subprime mortgage loans," but it "internally recognized that at least 12 percent of the single family portfolio was subprime."

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Now, where does 12 percent come from? It comes specifically from this table that's in paragraph 67 of the third amended complaint. This table is literally copied from the SEC case complaint, which didn't come out until

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late 2011. This information that's on here, whether you think it's true or it's not true, never was disclosed to the marketplace in any way by anyone until late 2011.

When the plaintiffs moved to amend to add these allegations, they said, "This is recently received information," just as the plaintiffs in the Central States case did. They also copied those same allegations into the complaint in that case.

Now, so as I said, OPERS concedes that the information was first revealed to the market four years after the class period ended.

For this exact reason, the Second Circuit held that the exact same allegations failed to plead loss causation. In the words of the Second Circuit, applying Lentell, the case that the plaintiffs want you to use, "Plaintiff fails to connect Freddie Mac's subprime exposure, or any alleged misrepresentations regarding it, to the events that are alleged to have caused the relevant stock price decline."

Now, in that case, the stock price decline was triggered when Freddie Mac was put into conservatorship in September of 2008, and its stock price dropped over 80 percent that day. Here it dropped around 30 percent, about a year earlier, because it simply announced a quarterly loss.

In this case, notwithstanding those facts, the Second Circuit said, "No, that's not loss causation, because this information did not trigger the loss. The loss happened in September of 2008, and nothing about those events revealed the falsity, the alleged falsity, of the challenged statements about the quantity of subprime loans in Freddie Mac's guarantee portfolio."

And if that were true, it's simply not possible here, under the same analysis, to come to a different conclusion, because here, this is a year earlier. Under the Second Circuit, applying its own law, it concludes that a year later, this information hasn't even been revealed to the market. So it couldn't possibly be the case that on November 20th, 2007, that information had already hit the marketplace, when the court concluded that a year later it hadn't yet, as it hadn't because it first hit when the SEC brought suit.

Now, OPERS says, "The materialization of Freddie Mac's risk of loss from subprime and other nontraditional mortgages caused the November 20, 2007 stock price decline."

If they are right, the Second Circuit would have had to have come to the opposite conclusion. They are obviously not correctly applying the Second Circuit law, because the Second Circuit applied that law to these exact same factual allegations, and said that even a year later,

that didn't establish loss causation.

And in their words, they say, "Plaintiff concedes that the non-prosecution agreement cited in the third amended complaint is not a loss-causing event, and otherwise fails to allege the existence of any corrective disclosure during the class period that reveals Freddie Mac's subprime exposure was vastly understated." And if that didn't happen as of the end of the class period in Central States, it couldn't have possibly happened as of the end of the class period here.

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Now, so plaintiffs' last argument here, because they say very little about Central States in their brief, is they say, "Well, it's distinguishable"; and here's why they say it's distinguishable: They say, "On November 20th, 2007, Freddie Mac supposedly disclosed," for the first time, for the first time, "its increased involvement in nontraditional mortgage markets and the 'greater credit risks' from 'increased delinquencies and credit losses' on such products."

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The problem with that is it's not what Central States' ruling said and it's not what happened, and the documents that are incorporated by reference in the complaint and Freddie Mac's SEC filings show that before and during the last period, Freddie Mac disclosed the very type of information that the plaintiffs say was supposedly first

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disclosed on November 20th, 2007.

So, again, on November 20th, 2007, there weren't any of those disclosures of the sort that came out for the first time when the SEC brought its suit, but there were previously these types of disclosures. Freddie Mac made no secret of the fact that it was increasing its purchase of nontraditional mortgage products, with some higher-risk characteristics that were going to cause those loans to default at a higher rate than more traditional mortgage loans.

It stated, "Freddie Mac's 2005 annual report, that it had increased its purchases of nontraditional, or alternative, mortgage loans, like interest-only loans, option ARM mortgages, to 550 percent the amount they had been in 2004."

And they disclose, and this is all in our -- we've put this all before you. It's in our brief. It's in the attachments. It expected that trend to continue in 2006, but this disclosure, the 2005, that's before the class period begins.

Then during the class period -- well, they said -- they said, in 2005, "We expect that this trend is going to continue in 2006. We're exploring ways to become more involved with these products. We expect our participation in nontraditional mortgage products 'to grow in the coming

years.' And we expect each of these products to default more often than traditional products."

And then, during the class period, Freddie Mac disclosed it continued to increase its purchase of nontraditional mortgage products in 2006, just as it said it would.

That was not concealed. It was disclosed along with all the credit characteristics, detailed credit characteristics, regarding all of these loans, all their FICO scores, all their LTV ratios.

Plaintiffs rely upon some cases where this kind of information is never disclosed. That's not the case here. It was disclosed.

And it's simply not true; it's not supported by the documents incorporated by reference in the complaint that Freddie Mac disclosed anything new about that subject on November 20th, 2007. What it said about that subject on November 20th, 2007 wasn't the first time it said it, and it was entirely consistent with everything it previously said about the subject. It didn't reveal the falsity of anything it said before, it was just consistent with everything it said before.

Now, I am about to switch gears to the subject of scienter, Your Honor, and before I do, I just want to say this: The subject that I just focused upon, loss causation,

that is independently a show stopper. For that reason alone, the case should be dismissed as to all defendants. Without being able to adequately plead loss causation, which plaintiff has failed to do, the case is legally defective and it should be dismissed.

15:00:31

Now, I am now going to talk about scienter, which is an independent reason for the dismissal of the case.

First I want to start with Sixth Circuit law. I'm focusing on the Ricker case. We rely upon it in our moving brief. Again, the plaintiff doesn't even cite this in their opposition brief. This is the law of the Sixth Circuit, Ricker.

15:00:48

Here is Ricker. They give you a sense for how high the standard for pleading scienter is in the Sixth Circuit. Here's the fact pattern in this case:

15:01:01

An accountant for the company personally warned the CEO and CFO that a major customer was not paying on time, which put the company on notice that SEC filings would be inaccurate.

15:01:15

The company's auditor issued an opinion raising substantial doubt about the company's ability to continue as a going-concern.

And then, the company announced a restatement of its financial results.

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Those were the types of information that was out

there. And the Sixth Circuit concluded as follows: The case -- they affirmed the grant of a motion to dismiss. And they say as to scienter, this is an adequately pled scienter as a matter of law and adequately pled, that "at most, this
15:01:51 shows that the company was financially mismanaged, not that the defendants had fraudulently misled the public."

Now, here, I am not going to dwell on this case, the Kuriakose case, I won't overrely on it, but there is one point I do want to make about it. This is the fundamental
15:02:16 scienter argument. This is a fraud case, Your Honor. These people we all represent, they are being accused of fraud.

And as Judge Keenan concluded when he looked at this issue, are there sufficient allegations to show that these people were trying to hide information, they were
15:02:34 deliberately trying to trick people, to mislead people, he concluded as follows: "The bevy of truthful disclosures that Freddie Mac made throughout the class period, covering everything from detailed credit characteristics to extensive risk assessments, negates an inference of scienter."

15:02:52 In his words, it defies logic to conclude that executives who are seeking to perpetrate fraudulent information upon the market would make such fulsome disclosures.

And he, last line, said, "If Freddie Mac
15:03:09 executives sought to shield investors from 'learning the

truth' of its business, they needed to be measurably more opaque."

Now, why did he say it? He said it because Freddie Mac disclosed so much detailed information. If you compare -- there is an explanation for why Central States came out the way it did, why Kuriakose comes out the way it did, as compared to other cases that the defendants rely -- that the plaintiff relies upon. And that's because they're factually distinguishable. Here, you've got Freddie Mac making extensive disclosures about everything having to do with its guarantee portfolio and the loans in the guarantee portfolio and its retained portfolio that enabled people to assess the degree of risk.

Now, I want to focus for a minute on an article that the plaintiffs cite in the complaint. This is one of the alleged misrepresentations, is based on this article, where they quote Ms. Cook from this article.

But here's what I want to emphasize about the article. It's from *Mortgage Risk* magazine in October of 2007, very close to the end of the class period. And what you see is, you see that Freddie Mac makes these disclosures and the street is aware, the investing public is aware of the risk characteristics of the Freddie Mac guarantee portfolio.

And what are they focused upon? Here's the

article: "Characteristics such as high loan-to-value ratios ('LTVs') and low credit scores are largely absent." I want to stop there for a second. Those are the risk metrics that folks who look at these things look at to assess the degree of risk presented by a book of loans. Those are the key metrics. That's why the article is focusing on those statistics. It's like if you were talking about sports and you said, "Well, what's his points per game and assists per game and rebounds per game?" There are certain key statistics. These are them.

So they go on to say, "In the words of one analyst, Freddie's book of business is 'about as good a book of loans as you could hope to find.'" This is in that article.

Now, they're focusing on the actual statistics themselves. So why do they say that? They say, "Loans to borrowers with FICO score credit lower than 620 make up 4 percent of the total portfolio." So they're reading these statistics. There is no challenge to the accuracy of these disclosures.

Then they say, "But significantly, loans with both original LTVs over 90 percent and FICO scores below 620 make up a tiny portion of the portfolio of less than 1 percent."

So you asked in your glossary about risk layering. That's risk layering. That's the issue of risk layering.

That's the difference. Freddie Mac's book of loans; yes, they had some loans to borrow with FICO scores below 620, 4 percent of the portfolio. They disclosed it. If some people define subprime that way, that's the amount. If it's below 660, they have disclosed the full amount of those loans. But as far as those two things being together, 1 percent of the portfolio.

Now, at the same time, the market also knew that if there was a substantial decline in home values, Freddie Mac was going to suffer losses inevitably. And specifically, this is what the article says that's quoted in the complaint: "Both Freddie Mac and fellow GSE Fannie Mae remain vulnerable to a substantial downturn in house prices, something that looks increasingly likely." The market knew this.

And then they go on to say, "Freddie Mac was created to support the mortgage market in good times and bad. How far that turns out to be an obligation, an opportunity, or both, perhaps depends on how bad the bad times turn out to be." No one had a crystal ball. Those analysts didn't have a crystal ball.

But what happened? This is what happened: The single largest decline in home prices in recorded United States history. As you saw, the analysts were aware, the street was aware, Freddie Mac was going to suffer losses if

there were home declines, home price declines.

If there is going to be the biggest home price decline in recorded history, it's going to hurt Freddie Mac. Freddie Mac's principal assets are home mortgages and mortgage-backed securities.

15:07:42

And Freddie Mac didn't hide that. As Freddie Mac repeatedly warned investors, a decline in home values was likely to cause Freddie Mac to recognize losses.

On November 20th, 2007, investors began to suffer losses from the effect of this decline in home values.

15:08:00

And there's nothing that Freddie Mac could do about it. But that's not fraud. It's not fraud. And there is nothing that the plaintiffs have alleged to show that that had anything to do with anyone at Freddie Mac trying to mislead anybody, or a revelation that they had.

15:08:21

Now, the point of this chalk is just to show you one thing. In these glossaries that you asked for, the plaintiff wants you to think that everything -- that Freddie Mac's guarantee portfolio was chock-full of the worst quality loans, that everything they had was equivalent of the loans that were literally labeled subprime loans by the originators, sold as subprime loans. That's the market for subprime loans. There were literally hundreds of billions of dollars of loans sold during this period of time that were originated by originators that called them subprime

15:08:48

15:09:04

loans -- subprime loans -- classified them as subprime loans, labeled them subprime loans, sold them as subprime loans. If they were called subprime loans, Freddie Mac wasn't buying them.

15:09:20 Now, what Freddie Mac was doing is, mortgage-backed securities that were backed by those subprime loans, Freddie Mac was buying that, just as it disclosed, literally over a hundred billion dollars in its retained portfolio of mortgage-backed securities, backed by 15:09:35 the loans that were classified and sold by the originators as subprime loans.

Now, back to the guarantee portfolio, though, because that's what this case is about. The proof is in the pudding. They talk about defaulting and risk of default. 15:09:51 These are the actual defaults of the loans. Here are the statistics on defaults. This is Freddie Mac's book. Freddie Mac's entire guarantee portfolio was defaulting at these rates of serious delinquency.

And if you look, even at the worst here, this is 15:10:10 at the end of December of 2009, let alone the class period, the default rate is less than 4 percent. The default rate for subprime loans, according to the statistics published at that time by Mortgage Bankers Association, these are just the public statistics, 30 1/2 percent default rate.

15:10:33 Freddie Mac -- if Freddie Mac's book was full of

subprime loans, things that are the same as subprime loans, it would have to be the case that the default rate for their book was much higher than this. In fact, the default rate was lower than a book -- the average default rate of all prime loans at the time, let alone all loans, and, of course, way lower than subprime loans.

15:10:50

So to conclude, Your Honor, while we have many arguments that we've made other than these, I thank you for your indulgence in allowing me to get through this presentation, thank you very much, for an eye focused on doing this presentation, although we have others, loss causation and scienter.

15:11:16

And to sum up the scienter argument, Your Honor, there just simply -- the law is Ricker. The standard is very high. That's the Sixth Circuit law that we cite, that the plaintiff ignores. And they have to allege specific facts that give rise to a strong inference of scienter, a strong inference that these folks really were trying deliberately to mislead people and hide things, rather than there being some more cogent explanation, some more logical explanation that the inferences would support.

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You might say, "Gee, that's a lot to ask on a motion to dismiss." No, not in a PSLRA case. Under the Tellabs case, the Supreme Court case on scienter, the court is required to make that assessment.

15:12:07

Now, here, I'm just going to mention the issue of stock trading. Unlike so many -- the plaintiff cites the Countrywide case. The defendants sold over $700 million worth of Countrywide stock. The CEO alone sold over $400 million worth of Countrywide stock. Okay. That was not insignificant in supporting the inference of scienter.

15:12:27

Here, as Judge Keenan pointed out in the oral argument in the Kuriakose case, it's certainly germane. Why would they do it? All of these defendants, they -- none of them made a voluntary sale of stock. The CEO, the CFO, the COO didn't sell any shares. They suffered $34 million of losses on their own.

15:12:46

Only one of the defendants made a small amount of trading, and that trading was pursuant to Rule 10b5-1 trading plan, which doesn't support any inference of scienter. And Freddie Mac itself repurchased $2.2 billion of its own stock.

15:13:04

These facts are completely inconsistent with the notion that the management team of Freddie Mac was deliberately trying to mislead people, and that they knew that the company was way worse off than they let on. They don't sell any stock, and they take a bath, and the company buys back $2.2 billion of its own stock during this period.

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So to sum up, the opposing inference -- and this issue, by the way, is also tied to loss causation, because

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the plaintiff relies on the Lentell case, and Lentell says, "When there are -- when there are macroeconomic events that cause similar losses across the board, then the burden is even higher in pleading loss causation." And that's what you have here.

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The plaintiffs just recently stuck in a case in their glossary that we've never seen before, where, of course, "There wasn't any other reason even suggested for the loss." This is the opposite fact pattern as that. This is the single biggest decline of real estate value in recorded history that causes losses across the board.

15:14:10

So the opposing inference here is the much stronger inference. There is nothing to support the inference that anyone was trying to trick anybody. And the far stronger inference is that the dramatic decline in home values caused Freddie Mac to report a quarterly loss at the end of the third quarter of 2007. There was simply no other -- there was no avoiding it.

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The market knew, as I showed you from the article from October of 2007, if there were big losses, if there were -- I mean, if there were declines in home values, Freddie Mac was going to suffer losses, Fannie Mae was going to suffer losses, no avoiding it. That happened. Biggest decline in home values in history. They reported a quarterly loss. That's not fraud.

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So for all of those reasons, we think that this motion to dismiss should be granted, and I thank you for indulging me today.

THE COURT: Thank you, sir.

15:15:10 Next, Mr. Kravitz?

MR. KRAVITZ: Yes. Good afternoon, Your Honor. I am Carl Kravitz for Patty Cook. I can give you a preliminary answer on the press release, and then -- because we went and took a look at this.

15:15:58 THE COURT: I'd appreciate it.

MR. KRAVITZ: And it appears -- I mean, the press release, as far as we can tell, is the same in both Freddie's filing and our filing, although it's a different format. It appears that we have consolidated financial

15:16:10 statements attached and something called core tables, and I think that Freddie's attachments are different. We will pursue that and make sure that we clear that up.

THE COURT: Thank you.

MR. KRAVITZ: But that's our preliminary report on

15:16:26 what the difference is. But in terms of what the release is, I believe it's verbatim.

THE COURT: Verbatim as?

MR. KRAVITZ: In other words -- in other words, the press release on November 20th that is attached to

15:16:37 Freddie's papers I think are the same words as ours. It's

about two pages, I believe.

THE COURT: Then identify those pages for me. And I know that plaintiff does draw my attention to two pages, which I think are pages 75 and 76 of the filing in your client's case. That's ECF 290, at Attachment 22.

But enough said about that. You know my quest. If it's those two pages or something else, you'll have some time shortly after this to make sure that I'm on the right page.

15:17:15 MR. KRAVITZ: Absolutely.

THE COURT: Pun intended.

MR. KRAVITZ: We will try to clarify that.

In any event, for Patty Cook, she should be dismissed for the reasons that Mr. Hershman just said, as well as all the individual defendants.

There are also some specific arguments that I believe apply to Patty Cook based on who she was in the company and the allegations as to her.

Just quickly as to who she was. She was an executive on the business side of the company. She was initially responsible for the retained portfolio, and then later the guarantee portfolio as well. And she became the chief business officer in June 2007, which was late in the class period. That's who she is.

15:18:05 This, as you well know, is a disclosure or a

deception case involved alleged -- involving alleged material misrepresentations and omissions.

Ms. Cook did not sign any of the company's information statements. She didn't actually make any of the press releases. And there is no allegation in this case that she drafted, edited or created any of the company's statements.

She was not on the Disclosure Committee, and it is not alleged that she was. Nor is it alleged that she supervised, oversaw or controlled the Disclosure Committee or investor relations part of the company. Those are the parts of the company responsible for drafting the information statements and the releases at issue. Those functions were in other parts of the company that reported up a different chain. So that's who she was.

I'd like to turn now to my first main substantive point, which is that there is no actionable material misrepresentation alleged in the complaint against Patty Cook. And I want to dispense with something first up front so that we can focus on what Patty Cook's statements were.

And that point is that Patty Cook, under controlling law, cannot be responsible for the company's statements, because she didn't make any of those statements.

Now, I am not suggesting in any way that those statements are false or fraudulent, it's just that she,

because of where she sat in the company and her role, didn't make the statements. There is no aider liability under the securities laws, only primary violators; in other words, those that make the statement can be held liable. That's the Janus case. And the Janus case makes clear what I believe was clear since 1994, that simply participating, creating or assisting in the statement behind the scenes is not enough in a private securities action.

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And as I said, Patty didn't sign the statements, they're not attributed to her, they don't even mention her. And based on where she sits in this company, she cannot be said to have ultimate control over the content of those statements. That's just not who she was.

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THE COURT: How do you place the analogy the Janus court used of the speechwriter and the speech-giver, how would you compare that to your client's role?

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MR. KRAVITZ: I would say that she's not even close to being alleged to be the speechwriter.

THE COURT: Uh-huh.

MR. KRAVITZ: And in Janus, obviously, the speechwriter is not liable, because the person who stands up and delivers the speech actually has ultimate control over the content.

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But she didn't -- there's no allegation that she drafted any of this stuff, she edited it. If the plaintiffs

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had something, they would. I know that there's a stack of documents that were produced in this case having to do with the Disclosure Committee, and if they had found something in that stack saying that Patty Cook had drafted anything, we'd know about it.

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And in any event, even if that made her the speechwriter, it doesn't make her the speaker and it doesn't make her the maker of the statement; and so under Janus, she can't be tagged with the company's statements, either in the information statements or the press releases. So that's sort of the first point that I'd like to make.

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And the one fact -- or the fact that they focus on, the plaintiff focuses on much -- mostly in regard to this is that she signed a subcertification under -- under Sarbanes-Oxley, she had to certify that to the best of her knowledge, that the financial statements as a whole were true and accurate.

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But that, by the way, is an internal document. It is not shown to the investing public. No one could rely on it. And so it couldn't give rise to liability for that reason.

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And in any event, you know, at most -- and we would dispute this vigorously, but it would be providing assistance to the statement-makers, and that's just not enough in a private securities action.

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So that's really the one fact that they focus on, factual matter they focus on. There's a lot of conclusory stuff, but that's the fact they talk about. So we believe that she can't be held liable for that and she should not be tagged for that.

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And that gets us to Ms. Cook's statements. And there are four of them, I believe, that are mentioned in the complaint, one in January of 2007, to the Citigroup conference; May 17th, 2007, to the Lehman conference; September 10, 2007, to another Lehman Conference; and October 2007, there are statements in a mortgage publication.

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And here's another thing that I'm just going to say, because there's no way that I could address this in this time frame, but that virtually everything complained of in the statements that Ms. Cook actually made fall into the category of soft opinion, puffery, prediction of the future or statements that would speak caution.

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We've got a chart for all of those. And that covers most everything. The comeback is, "Well, yes, that's the law," except if you have actual knowledge that those soft statements are false, we don't believe, and we've argued in our brief that there is no allegation of actual knowledge that those were incorrect. But we will rely on our papers for that. It's just too detailed for this.

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So that really gets down to I think the one statement in the things that Patty actually said that's not non-actionable on its face, and that's where she said, "Basically" -- "There's basically no subprime in the guarantee portfolio." And I would like to address that. That was at the Lehman conference in May of 2007, and she said a few similar things otherwise.

15:24:11

And we've heard some argument on this today, but this is -- this is sort of the take on it that I think I'd urge the court to consider: That if you ask yourself, what are the facts about Freddie's portfolio in this time frame? And that -- you heard Mr. Hershman, but in 2005, 2006, as you start moving towards the financial crisis, the company was guaranteeing or purchasing more loans with higher risk and more nontraditional products. Those are the facts.

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And not only that, but Freddie's risk increased as the housing market declined and credit deteriorated. Those are the facts. Those are the material facts that an investor would want to know about this company. That's the core of it.

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And I think that you heard from Mr. Hershman, but it's true with respect to the company, but it's very true with respect to Patty Cook. She disclosed those essential, material facts that are important to an investor. And we've cited things at page 21 of our brief and reply at 17.

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But here are the things that I'd like to focus on: She specifically disclosed increasing numbers of nontraditional products, including option ARMs and interest-only loans and risk-layered products. And I cite to the TAC at paragraph 152, and Exhibits 16 and 14, which are attached to our brief. And those are documents incorporated by reference in the complaint. That's number one.

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Number two, the company's disclosures also set forth the loans with high loan-to-value ratios and low FICO scores. In other words, they gave granular data regarding factors associated with the company's higher credit risks. And that was -- so that that information is clearly out there and part of the mix of information.

15:26:08

Ms. Cook also specifically referred in her statements to Freddie's increased credit risk. At TAC 152, it's alleged that she said there were growing risks associated with alternative mortgage products.

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And in TAC 170, she referred to a period of heightened credit risk.

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And then lastly, Patty also said that she specifically said that Freddie's portfolio was sensitive to declines in the housing market and deterioration of credit. And that's at TAC 186, where she specifically said, "When the housing market does poorly, our credit losses go up."

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And that is quotes in a magazine article.

So I believe, and I would urge the court to accept that, that Patty Cook, like the company -- but Patty Cook actually disclosed the essential facts, the material facts, what's important about this company's portfolio.

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And so what does the plaintiff say about this? What the plaintiff says about this is that in addition to disclosing that there were more loans with higher risks and more nontraditional products, it should have also labeled some of those loans as subprime, and that failing to do it was a material omission.

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And that's really -- in my view, that's what this case comes down to, whether or not you buy that argument. There are all the other issues about scienter and loss causation, on which I believe we win as well. But in terms of falsity, that's what it really comes down to.

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And on this falsity point, I have four quick points to make. The first is that disclosing the material substantive facts should be enough. And I cite the court to the Benzon versus Morgan Stanley case. It's in our brief. It's a 2005 Sixth Circuit decision. And there the court held that where the substantive facts were disclosed, you can't sue someone for failing to characterize them.

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That case involved four different classes of stock, and the claim was, "Well, you didn't characterize

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that or label them as to what would be best/the worst for investors." And the court rejected that. And we think that that is on point here.

The second point I'd like to make on the falsity point is that -- and I refer to TAC at 120. But the allegation there, and it incorporates it -- it discusses the senior executive training meeting in February of 2007, and there is a set of slides that went along with that, that meeting.

15:29:16 And it was said there, according to the allegations, that "It was generally understood that subprime were loans purchased from self-identified subprime originators."

And that's what is alleged that the people -- 15:29:32 attendees at that meeting believed. Patty Cook was there, as were others. And by that alleged definition, these statements, in terms of how much subprime were in the portfolio, are true. There is no argument that if the standard is, did these come from the subprime channel -- 15:29:52 now, there is the self-identified subprime lenders -- that the numbers in these disclosures and the numbers mentioned by Patty Cook are true.

So that's number two, which is that by that standard, this is true. And there is no reason why you 15:30:09 should be able to say that having disclosed the facts, and

it's true by that standard, which they allegedly believe, that somehow they had some obligation to label these things differently.

The third point that I would like to make is, is that it would have been misleading to label the loans with higher risk as subprime.

And I would like to refer the court to this chart that Mr. Hershman put up here, which has -- it shows the difference in serious delinquencies between the subprime channel, or subprime segment of the market, and what was going on at Freddie Mac.

And in order for the plaintiff to sustain its burden of showing that the loans with higher risk could properly be classified as subprime, they would have to allege that they performed like subprime.

And it is not alleged that those loans performed like subprime. They can't allege that those loans performed like subprime, because it would be simply not true. And I tell you that if they could make that allegation, they would.

And the idea that we are here because they said that we should have labeled loans with higher risk that we disclose, something that is just not justified by the facts and they haven't alleged, I think defeats their claim.

And then the last point I'd make on falsity is

that there was no universal definition of subprime in the market. Yes, Freddie Mac, or at least the attendees at the SET meeting and Patty Cook believe what I just said. But there was no universally accepted definition.

15:31:57 And given that, labeling the nontraditional loans and loans with higher risk as subprime does not add to the mix of information, particularly where the underlying facts are disclosed. The label, where there was no generally accepted definition of what it means, doesn't really add

15:32:13 anything to the disclosure that "Hey, we've got these loans." And for that reason, I think that the allegations about the falsity of subprime just don't stand up.

Let me then say -- I have a couple points on scienter, and then I'm done.

15:32:33 THE COURT: And how much longer will you be before you're done?

MR. KRAVITZ: I will be two minutes.

THE COURT: Okay.

MR. KRAVITZ: Okay. I'll go really fast.

15:32:40 THE COURT: Well, I want to understand you, so --

MR. KRAVITZ: Okay. If I go too fast, I'm sorry if I --

THE COURT: No, no, no, so far you've been fine. If you go faster, you might give our court reporter a

15:32:50 problem.

MR. KRAVITZ: Okay. I will try to do it.

In any event, scienter is another issue that has to be decided defendant by defendant. The plaintiffs say that the Matrixx court case from the Supreme Court
15:33:05 essentially overruled the PSLRA's requirement that you have to allege scienter as to each alleged misrepresentation and omission. That's not what we believe the case says.

But in terms of Patty Cook's scienter, I want to make four points here, too. The first is, and I've
15:33:25 mentioned this, at the SET meeting in February of 2007, it is alleged that the attendees, including Ms. Cook, believed that the definition of subprime was from self-identified subprime originators; in other words, the subprime channel. And if, by that definition, which she believed the statement
15:33:43 was true, and it undoubtedly was true by that definition, then there can be no fraudulent intent. That's number one.

Number two is that there are many facts or scienter negating facts alleged. And I'm going to point to -- a lot of that's in the brief, and the plaintiffs
15:34:07 explain why they don't think that's right. I just want to call the court's attention to two of them.

In Exhibit 18, which is what goes along with the March 2000 Board of Director meeting, it makes clear that Ms. Cook believed that subprime was an adjacent market; in
15:34:30 other words, adjacent to what Freddie did, and was a market

that the company had missed.

And in the SET meeting, which is February of 2007, and it's Exhibit 19, when you look at the charts, it shows that, there's something that says, "Where we are not." And under that heading, you see all of these different items of subprime. And then it essentially asks the question: "Well, should we move into those markets?"

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And my point is that this is entirely consistent with respect to Ms. Cook, that she believed that subprime is measured by, does it come from one of these originators. And when you look at these things, it shows that she believed they were not in that market, measured by that standard, and they had missed it, it was adjacent, and they were saying, "Should we get into it?" That's number two.

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Number three is when you look at her actual statement, the quote is, "Basically no subprime exposure in our guarantee business, and 124 billion of AAA-rated subprime exposure in our retained portfolio."

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It just simply makes no sense that Ms. Cook would disclose $124 billion on the retained side, but somehow obscure the subprime on the guarantee side. Both are measured by the same standards I've just mentioned, and that negates scienter.

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In terms of her stock sales, they say nothing about her scienter. Six were forfeitures, two were pursuant

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to 10b5-1 plans, and they are presumptively not suspicious. And she retained 94 percent of her stock and lost $4 million when the market went down.

So I would like you to focus on those when you think about Ms. Cook's scienter.

And then I would just say that the case should be dismissed with prejudice. And because there is no way to cure some of the main defects here, one, you can't fix the fact, if you're the plaintiff, that the essential facts were disclosed. That can't change. That's historical fact.

And, number two, you can't allege what you need to allege to say that the loans with higher risk perform like subprime. That's historical fact. They did not. They can't go back to their office and replead this case and overcome those defects. Those defects are matters of historical fact. They've had four chances now, and it should be dismissed with prejudice. Thank you.

THE COURT: Thank you, sir.

Mr. Goldfarb?

MR. GOLDFARB: Good afternoon, Your Honor. James Goldfarb for Defendant Anthony Piszel. And, Your Honor, we had a bet about whether the defendants would be able to keep within their hour time limit. I'm pleased to let you know that I won, so I have very little incentive to keep running the clock here, and I'll be brief.

THE COURT: I appreciate that.

MR. GOLDFARB: The court should grant Mr. Piszel's motion for the reasons already outlined, Your Honor. I just wanted to highlight three additional reasons unique to Mr. Piszel, and these have to do with scienter.

15:37:51

In short, Your Honor, Mr. Piszel did not deceive anyone, intentionally, recklessly, negligently, or otherwise.

And the third amended complaint does not plead facts that give rise to any inference, let alone the required strong inference, of scienter.

15:38:04

In fact, OPERS' own allegations raise a compelling inference of the exact opposite. First, OPERS tries to get traction from the SEC proceedings, but that is a non-starter. Mr. Piszel is not even a party to that action. Indeed, after its three-year investigation, the SEC did not charge Mr. Piszel. Instead, it issued him a closing letter. In Ceridian, the Eighth Circuit held that similar facts gave rise to a compelling inference that defendants there lacked scienter.

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OPERS has no response to Ceridian, or to the fact that Mr. Piszel is never mentioned in the SEC complaint or the court's decision on the motion to dismiss.

Second, OPERS tries to get traction from alleged stock sales and bonuses, but that too is a non-starter.

15:39:01

OPERS admits that Mr. Piszel made no stock sales during the proposed class period, and it does not deny that Mr. Piszel lost $5 million when Freddie's stock price declined.

Stymied by these facts, OPERS attempts to amend its complaint in its own opposition papers. It alleges that Mr. Piszel was motivated to commit fraud to receive $208,000 in dividends on restricted stock units.

But even if the law permitted OPERS to amend its complaint and put new facts in its opposition papers, which the law does not permit them to do, OPERS' argument simply does not add up. OPERS is asking the court to conclude that motivated by $208,000 in dividend payments, Mr. Piszel put at risk $5 million in his stock holdings. Courts simply do not draw such economically irrational conclusions, even on a motion to dismiss.

Third, and finally, Your Honor, OPERS tries to allege that the individual defendants knew, or should have known, that their statements were false or misleading when made, but that too is a non-starter.

OPERS points to supposed subprime-related developments at Freddie Mac, but Mr. Piszel is not mentioned in any allegation about those developments, many of which predated his arrival at Freddie Mac.

OPERS also alleges that the individual defendants received or had access to information inconsistent with

their public statements. They didn't. And, again, OPERS does not allege that Mr. Piszel was involved in or even aware of communications, meetings or reports supposedly containing such inconsistent information.

15:40:56 And so, Your Honor, let's just take a step back, because as OPERS says in its papers, you are required to consider the scienter allegations holistically.

Here's what the complaint shows holistically: Mr. Piszel joined Freddie Mac three months into the proposed

15:41:14 class period. He was not intimately involved with the single-family business. He did not receive any material information contradicting his subsequent statements. And he lost $5 million by not selling Freddie Mac during the time that he supposedly knew about a fraud.

15:41:34 Why would he mislead the market then? OPERS gives a reason that is simply common to all executives: To protect his job, and, although they never actually plead this, the possibility that $208,000 in unvested dividends eventually would vest.

15:41:53 We know of no court that has found these facts to give rise to a strong inference of scienter. Simply put, they are neither cogent, nor compelling.

And finally, Your Honor, what I'm saying is not news to OPERS. We made these arguments on the initial

15:42:11 motion to dismiss, and here. OPERS has had ample

opportunity to respond. Its silence speaks volumes; and, therefore, the court should grant the motion.

If you have any questions, Your Honor; otherwise, I will sit down.

15:42:24 THE COURT: Please sit down. Thank you.

MR. DOLUISIO: Good afternoon, Your Honor. My name is Mike Doluisio. I represent Gene McQuade.

I join in all the arguments that the other defendants have raised. It seems to me that the plaintiff 15:42:46 hasn't stated a claim against anybody. But I wanted to come up and talk about some of the circumstances that provide additional support for why the plaintiffs' claims against Mr. McQuade fail.

As we pointed out in our brief, there are some 15:42:59 special circumstances for Mr. McQuade. He didn't sign or certify a single one of Freddie Mac's statements at all during the class period. And I'm not trying to imply that there's something wrong with those statements, but he didn't have that responsibility with regard to them.

15:43:15 His tenure at Freddie Mac ended well before the end of the class period. He resigned in the spring of 2007. And although he stayed at the company for a few more months, his job was effectively reassigned to someone else as soon as he gave his resignation.

15:43:30 He sat on the Board of Directors, but didn't sit

on a single board committee. He did not sell any stock during the class period. He did have some forfeitures for tax reasons. And in our briefing we cite five cases holding that forfeitures don't give rise to an inference of scienter. Instead, he held, and he lost, a lot of money. He lost about $11 million.

15:43:48

Plaintiff does not allege that Mr. McQuade analyzed the credit risk of the mortgages in the guarantee portfolio. Plaintiff does not allege that Mr. McQuade was responsible for deciding how the mortgages should be described. They don't allege that he signed any subcertifications, served on a Disclosure Committee, or had any other responsibilities with regard to Freddie Mac's disclosures.

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15:44:16

None of the confidential witnesses has a thing to say that's relevant to plaintiffs' claims against Mr. McQuade. In Exhibit D to their brief, plaintiffs list every alleged misrepresentation that Mr. McQuade allegedly made, and then they list the facts that they say show that the statement is false and was made with an intent to defraud. Not one of the confidential witnesses is mentioned anywhere in Exhibit D to the plaintiffs' brief.

15:44:32

And significantly, after a lengthy investigation, the SEC chose not to bring an action against Mr. McQuade. They didn't even send him a Wells notice, which is a letter

15:44:50

saying that the staff is contemplating recommending an action.

So it is true that the plaintiff advocates for a holistic view of scienter. I would submit that these facts strongly suggest that the plaintiff has not alleged a strong inference of scienter with regard to Mr. McQuade.

15:45:04

Now, in its brief, the plaintiff tries to gloss over these facts. It consistently lumps the defendants together in a way that's really misleading.

15:45:19

On page 43 of their brief in opposition to the individual defendants' motions to dismiss, they say that all of the individual defendants ratified, approved and certified Freddie Mac's statements. That's not true. And the allegation of the complaint that they cite says nothing like that about Mr. McQuade.

15:45:36

The closest that the plaintiffs say about Mr. McQuade is that he was "responsible for ensuring the accuracy of Freddie Mac's financial reports and disclosures." They offer no support for that conclusion.

15:45:52

As I mentioned, they don't allege that Mr. McQuade drafted, certified or had any other responsibility for Freddie Mac's public statements.

Even if their allegation was true, Your Honor, it wouldn't matter. In the PR Diamonds case by the Sixth

15:46:08

Circuit, the plaintiff alleged that the chief operating

officer in that case had access to all company information, and even controlled the public's disclosures. And the court said that those allegations were not sufficient to establish scienter.

15:46:24 So because Mr. McQuade did not certify any of the public disclosures, he can't be responsible for them. That does flow from the Janus decision, and Your Honor's decision in the Louisiana Municipal Police Employees' Retirement System case.

15:46:38 So that means we've got to look at the few allegations that are made about Mr. McQuade. Plaintiffs allege that he made oral misrepresentations on three days: October 3rd, 2006; February 8, 2007; March 23rd, 2007, about seven or eight months before the end of the class period.

15:46:58 In our reply brief, we addressed every single alleged misrepresentation that the plaintiffs had listed on Exhibit D to their brief. It would be much too time-consuming and difficult to go through each of them.

But I did want to go through just one example,

15:47:14 because my client has been sued for fraud. And I think when you look at just one example, it really does illustrate the sorts of problems that pervade all the allegations against Mr. McQuade and the other defendants.

Plaintiff alleges that Mr. McQuade made a

15:47:30 material, fraudulent misrepresentation when on October 3rd

he said, "Looking at capital, we continue to maintain a strong position there." They say that that was a fraudulent statement.

A number of problems with this: First, it's not false. On that day, the company disclosed that it had regulatory core capital of $37.1 billion. Plaintiff does not allege that the company's disclosure in that regard is false.

OFHEO, O-F-H-E-O, issued a report about Freddie Mac for the entire 2006 year. That report came out in March of 2007. Talking about 2006, the time period covered by Mr. McQuade's statement, OFHEO said, "Freddie Mac was adequately capitalized and maintains satisfactory cushions above statutory, regulatory, and OFHEO-directed capital levels."

The statement is also pure puffery. I mean, he says "capital position is strong." We cited a couple of cases saying that the word "strong" is puffery; the plaintiffs ignore them.

The statement is also immaterial. Investors don't care about the characterization that is put on hard facts, they care about the hard facts. And here the hard facts had been disclosed: 37 billion in regulatory core capital.

The statement is also an opinion. To the extent it could be actionable at all, and it is not, it's an

opinion by Mr. McQuade that he believes regulatory core capital is strong. Plaintiffs allege no facts suggesting that Mr. McQuade did not believe that regulatory core capital is strong.

15:49:14 So, Your Honor, that's just one example of the kind of allegation that Mr. McQuade is being sued for, and is being sued for fraud.

With that, unless Your Honor has any questions, I would just like to reiterate that, you know, Mr. McQuade is

15:49:29 in a different situation here, and the allegations that you do have to look at one by one don't state a claim.

THE COURT: Thank you, sir.

MR. DOLUISIO: Thank you.

THE COURT: I think that satisfies the opening

15:49:42 presentation by the defense. Am I correct?

MR. HERSHMAN: Yes, Your Honor.

THE COURT: Now for the plaintiffs.

MR. STOCK: Good afternoon, Your Honor. Chris Stock on behalf of the plaintiff.

15:49:59 THE COURT: Good afternoon.

MR. STOCK: A little housekeeping before I get into addressing the arguments. You've heard arguments from the defendants to this point about essentially loss causation and about scienter, with a sprinkling of

15:50:14 misrepresentations and omissions thrown in.

I will be addressing the loss causation arguments. My colleague, Mr. Wayne, will be addressing the scienter-based arguments. And we'll both be addressing misrepresentations and omissions as they come up through our presentations, if that's okay with the court.

THE COURT: It is, but let me give you some indication of what I'd like to hear from one or both of you.

MR. STOCK: Sure.

THE COURT: And there are a couple of things in particular. I appreciate the glossary submitted by both sides. In your third amended complaint, you identify five topics: subprime exposure, underwriting guidelines, fraud detection, risk management, capital position.

I'm not sure, from the drafting of that document, whether or not you allege that each of those five topics allege a separate claim, or whether it's possible that one could be a subtopic to the other.

For instance, that as a subtopic to subprime exposure, there is the underwriting guidelines or fraud detection.

Do you understand?

MR. STOCK: I think I understand, and I'll take a stab at --

THE COURT: Well, don't take your stab yet, because I'm going to give you my laundry list so that you

and Mr. Wayne can decide, because ideally you both don't need to speak to me about these. If it fits better into one's presentation than the other, then you can do that. But if both need to address it, you can.

15:51:44 I have been struggling with the definition of "subprime," and that is the initial reason that I requested that you submit the glossary.

Tell me, one or both of you, how do your allegations regarding subprime and the deceit that you

15:52:04 believe happened regarding subprime, how does it meet the pleading requirements if there is no single or uniform definition of "subprime"?

I think it's true that throughout the 284 paragraphs of the complaint, there are possibly three that

15:52:26 I've been able to divine, maybe more, definitions, but I can't tell which definition of subprime is used at any -- "any" is too strong -- at certain, key for my holistic review, times.

Do you follow what I mean there?

15:52:47 MR. STOCK: I follow, yes.

THE COURT: Okay. So if one of you could identify that, or give me what guidance you are able to. And you've already heard the global question that I put out to both sides: If you can help me to understand what press release

15:53:03 you referenced at, and I believe that's paragraph 190 of the

third amended complaint. I wish it were attached, but it's not. It's certainly something that I can consider because it's incorporated at least by reference, but I'm not sure what document it is that you're referring to.

15:53:20 And as I say, later in your pleadings you refer me to pages 75 and 76 of an attachment to Ms. Cook's brief, and if that's it, tell me.

Now, if you can work that into the time allotted, you'll satisfy me.

15:53:34 MR. STOCK: I think I can, but could I ask a clarifying question of the court? It deals with the first issue that you raised.

I understood you to be asking if these are separate claims -- if, for instance, nontraditional

15:53:51 mortgages, subprime mortgages are separate claims as they relate to underwriting standards or risk management practices.

What is the question that the court wants answered so I can do that?

15:54:05 THE COURT: Or are you saying that the defendants committed fraud in each of these ways, regarding subprime exposure, regarding the use of underwriting guidelines, regarding fraud detection, software or otherwise?

Do you follow what I mean?

15:54:21 MR. STOCK: I do. I do. Thank you for that

clarification.

THE COURT: Sure.

MR. STOCK: I will attempt to address your questions off the top here. It is interesting that -- I think I have some slides that sort of help get us focused in the right direction.

15:54:34

The first question, though, that you asked, I think the very easy answer to it is, the plaintiff has alleged as a global matter that securities fraud was committed, that misrepresentations and omissions were committed in the context of all these different issues.

15:54:50

There were misrepresentations and omissions related to subprime, for instance. There were misrepresentations and omissions related to risk management practices, related to underwriting standards, with the fact that Freddie Mac was representing that it had very stringent underwriting standards and was following those underwriting standards, when, in fact, the company wasn't following those standards at all.

15:55:04

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You look at risk management practices. You see disclosures in the -- in the annual reports and the information supplements that suggest, "We have a very strong and high level of risk management practices." Well, the complaint alleges throughout, and we discuss it quite a bit in our briefs, that, in fact, they weren't following these

15:55:37

risk management practices.

And with respect to the first issue that you raised, the subprime and other nontraditional exposure, there are representations made throughout the annual report, and in all of these information statements throughout the class period, suggesting a minimal to negligible amount of exposure to these subprime and nontraditional topics. However, internally, these folks were recognizing, "We have a significant amount of subprime and nontraditional."

15:56:11 And one issue that sort of overlies all of these is the question about credit risk. Because -- and I plan to discuss the corrective disclosure in this case that goes to your second issue, that what was the corrective -- what happened on November 20th, the paragraph 190 issue.

15:56:32 I plan to show the court what exactly did happen in that disclosure. I will point the court to it. And I will show the corrective disclosure in the context of credit risk misrepresentations.

Because credit risk is sort of the barometer for

15:56:50 this company. All the other things that I just discussed, subprime and nontraditional, risk management, underwriting standards, everything falls under the umbrella of credit risk. It was a top-of-the-mind issue for these investors.

And I say that because we recognize that Freddie

15:57:05 Mac is a monoline business. It buys and sells mortgages,

essentially. And so when a company -- excuse me. When an investor is asking, "What's the credit risk with this company," it's essentially asking, "What's this company's financial health?"

15:57:21 And with Your Honor's permission, I'd like to get into how that credit risk was being portrayed in the context of loss causation.

Because what we've heard from the defendants to this point are a number of issues about why we haven't pled 15:57:36 loss causation. We haven't pled loss causation or materialization of the risk. We haven't pled loss causation because there's been no corrective disclosure. We haven't pled loss causation because of these factual issues about how, "No, no, Freddie Mac did disclose its increased 15:57:51 participation in the nontraditional mortgage. Freddie Mac did disclose that it had some subprime, or that this definition of subprime is a nebulous definition."

And I'll get to that. But I want to address your third point right off the top before I get into loss 15:58:07 causation. And the question was, as I understood Your Honor, you were having some -- maybe some cognitive dissidence as to what definition is being used with respect to subprime throughout the complaint.

And one of the issues that we heard from Freddie 15:58:29 Mac, I think already, or I think it was actually

Mr. Kravitz, Defendant Cook's counsel, was there is no universal definition of subprime. We heard that.

And what the plaintiffs are alleging -- Kevin, if you could, please turn to slide 52. I've already given it to her; just give them to the defendants.

15:58:57

Now, we added the definitions of subprime to our glossary. I want to take a step back and talk about a hypothetical, a counterfactual. If Fred -- I direct the court's attention to the second cutout there, Freddie's subprime definition. And this comes from ECF number 298-37, and that's at page ID 13618 and 619.

15:59:16

THE COURT: Is that what I also have here in this binder?

MR. STOCK: It is. Your Honor, it's slide 52. The numbers are there at the bottom.

15:59:30

THE COURT: Thank you.

MR. STOCK: And what I was directing the court's attention to was the first sentence in the second pullout, where it says, "Freddie's Subprime Definition." And I want to start with a counterfactual to address the court's third question.

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If, if Freddie Mac would have said, "There is no universally accepted definition of subprime," period, and on the basis of the fact that there is no universally accepted definition of subprime, Freddie Mac would have not disclosed

16:00:04

any exposure to subprime, we wouldn't have a case, at least as it relates to subprime, at least as it relates to subprime. We'd have a case with respect to credit risk, nontraditional, all the other stuff, but we wouldn't have a case with respect to subprime.

16:00:21

But that's not what Freddie did, and here's why: If you look at -- this is the same -- the annual report, the 2006 annual report. That's ECF 298-2, and the page ID is 12402. Defendant Syron, in his key message from the chairman, says to investors, mortgage loans are "made to borrowers having spottier credit histories and posing higher risks." Okay. Freddie continues with that, that sort of vague notion of subprime, in the statement that I just read to you, 298-37, where Freddie doesn't stop with saying there's no universally accepted definition of subprime.

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Freddie goes on to say, "The subprime segment of the market ..." and I'll skip down "... such loans typically have a mix of credit characteristics that indicate a higher likelihood of default and higher loss severities than prime loans. Such characteristics," and they go on, "might include a combination of high loan-to-value ratios, low credit scores or originations using lower underwriting standards such as limited or no documentation of a borrower's income."

16:01:29

So what Freddie and Defendant Syron are saying to

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the public is, "Hey, we understand what subprime is, we understand that there's no universally -- there's no universally accepted definition of subprime, but we're going to tell you what we believe it is." Defendant Syron: "We
16:02:02 believe subprime loans are made to borrowers having spottier credit histories," this broad definition.

And in the context of these broad definitions of subprime, Freddie Mac represents that it has ".1 percent subprime in our guarantee portfolio." Freddie Mac doesn't
16:02:23 say, "Hey, we only define subprime as loans originated -- loans originated by subprime lenders." You can see that's not in these definitions here. And, by all means, the defendants can go to ECF Number 298-2 and -37.

And in the context of those discussions about
16:02:45 subprime, never once does Freddie Mac or Defendant Syron put the limitation on it that you heard them suggest today. It has always, always defined subprime as broadly as what you've seen quoted here. And that's for a reason.

Because if Freddie Mac defines subprime with its
16:03:06 arms wide open like this, and then tells investors, in the very next paragraph, that "And, oh, by the way, we only have .1 percent subprime," well, then that's a pretty strong signal to investors that "Wow, the mortgage loans made to borrowers having spottier credit risk and posing higher
16:03:30 risks, they only have .1 percent of those, that's a company

who's stayed away from the subprime loans. We're going to invest on that basis."

That's the problem with Freddie Mac's loosey-goosey definition of subprime here. Again, counterfactually, if Freddie Mac would have suggested to the investing public that "By the way, Investing Public, we are only telling you, we define subprime loans incredibly narrowly, we define them to mean only originators who have originated as subprime," then we wouldn't be here talking about misrepresentations and omissions. As they relate to subprime. We'd still have all the others.

So if that's addressed the court's sort of initial --

THE COURT: It does, in part.

Let me ask you, you heard Mr. Hershman's representation that touched I think directly upon this, and he used a slide, which you had a copy of, although you may not have been able to see the blowup, the one that begins, according to OPERS, "Freddie Mac disclosed that as of the second quarter 2007, only .1 percent of its single ..." you know the slide I mean.

MR. STOCK: I believe so.

THE COURT: I think your -- Mr. Lewis is handing it to you.

MR. STOCK: Thank you.

THE COURT: Do you have something that looks like this?

MR. STOCK: Oh. This comes from paragraph 67 of the complaint. Yes.

16:04:54 THE COURT: Right. And I'd like you to, if you can, to include Mr. Hershman's response to what you've just said, meaning make your statement that you've just made now more directly responsive to what he said moments ago. Because I think he's quoted what you've said just now as

16:05:18 having been said by plaintiff earlier.

I'm correct on that, aren't I, in that first bullet point?

MR. STOCK: Yes, that is correct. That is a correct statement in that we've alleged that, and actually,

16:05:36 the documents have proven that out. Although, again, we're here on a motion to dismiss. Because of the unique procedural posture here, we've seen the documents bear that misrepresentation out.

We have alleged that, yes, when you look at --

16:05:53 when you get more granular than the two definitions that Freddie Mac has put here in its -- in its annual reports and such, Freddie Mac internally was defining subprime to mean all loans, including EA, C1 and C2.

And EA loans are expanded approval loans. They

16:06:17 are -- technically, they are loans that come in through

Fannie Mae's automated underwriting system. It's a classification for a loan that is highly risky. The same with C1 and C2.

So internally, they have a system for determining exactly what was subprime and its credit risk.

And remember, when we talk about subprime, when we talk about nontraditional loans, when we talk about Alt-A loans, the question isn't really, how much subprime do you have? The question is really, what does the credit risk look like?

So you could think of credit risk as being, how likely is it that any given loan in this portfolio is going to go belly up? And so internally, they had a number of metrics that they used to figure this out, one of which was looking at EA, C1 and C2 as a combination, in recognition that each of these loans was either "clearly" subprime, or had subprime risk, or all internally recognized to be subprime. So that's the allegation. Again, I've said it's borne out in the papers -- in the documents we've received. We'll be back here presumably on summary judgment discussing those issues.

But the allegation, as it's pled in paragraph 67 of the complaint, is, internally they recognized this to be subprime, at 12 percent, while externally they're telling the public, "We only have .1 percent subprime." That's a

one to one misrepresentation. And Mr. Wayne will come up here and he will explain the scienter behind the misrepresentation. But that's where the misrepresentation comes from.

16:08:00 THE COURT: Thank you.

MR. STOCK: Okay.

To go back to Mr. Hershman's discussion about loss causation, Mr. Hershman suggested a number of ways in which we had not pled loss causation. And it's like I -- I was

16:08:23 writing down Mr. Hershman's arguments as they came, and I expect to be able to address each one of them. It looked like Mr. Hershman said, you know, "The Sixth Circuit doesn't allow the pleading of materialization of the risk," or "We haven't had a corrective disclosure here," or "Central

16:08:42 States controls," and so on and so forth.

So before we get into Mr. Hershman's arguments about why he thinks we haven't pled loss causation, I thought it might be helpful for the court to sort of affirmatively talk about what the Sixth Circuit, and in

16:08:55 particular, what the Northern District has found to be adequate allegations of loss causation.

THE COURT: The Sixth Circuit would be my greater preference, because as you know, while I have great respect for my colleagues, their actions don't bind mine, nor mine

16:09:08 theirs.

MR. STOCK: I understand. I understand. I think by way of example, Judge Carr's decision in the Hawaii Ironworkers case, which came from 2011, does, in my view, an excellent job of looking at Dura, which is the seminal loss causation opinion out of the Supreme Court, and applying that in the context of the complaint there, the allegations there. Similar to what happened in the Almost Family case, and the other cases upon which Mr. Hershman relied.

16:09:28

If you look -- slide 4, Kevin. Excuse me. Kevin, let's go to slide 6, please.

16:10:01

This is the formulation that Judge Carr used in Hawaii Ironworkers. Again, not binding, but probative in the sense that he's taking right from Dura. It's a three-part test, and it's a -- it's, again, citing the Dura case. If you look at part 1, which is at page 7, the first question that was asked, again, in connection with Dura: "Did the plaintiff allege that the company's share price fell significantly after the truth became known?" This is the first question the court asks.

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16:10:37

And, of course, we allege that all over the third amended complaint. In particular, you see that in paragraph 6, the second sentence there: "As a direct result of the revelation of Freddie Mac's subprime exposure and financial peril, the value of Freddie Mac common shares dropped 29 percent in one day and the owners of Freddie Mac shares

16:10:55

immediately lost approximately $6.6 billion in share value." So we have alleged that the company's share price fell significantly after the truth became known.

The second question that Judge Carr asked on the basis of Dura is: "Did the plaintiff specify the relevant economic loss?"

16:11:12

And we see that again all over the third amended complaint. In particular, paragraph 191. And we also just discussed that in connection with paragraph 6. I won't review it again.

16:11:26

The third question that Judge Carr asks, or breaks into two, and that first part is: "Did the plaintiff allege that defendants' conduct artificially inflated the stock price?"

16:11:41

And you see in paragraph 269 of the third amended complaint that, yes, we do, in fact, allege that defendants' conduct artificially inflated the stock price.

And the third and final question of the Hawaii Ironworkers test is: "Did the plaintiff allege some partial revelation of 'the nature and extent of defendants' fraud,' and did the share price fall as a result of this revelation?"

16:12:02

Again, I am not going to spend my time reading to the court. You will see that in paragraph 61, in fact, we do allege the nature, extent and effect of the fraudulent

16:12:13

scheme revealed, and we do again allege that the share price fell as a result.

Now, quoting Dura, Judge Carr notes -- and you can see that at our slide 5, quoting Dura, Judge Carr notes that "The pleading rules for loss causation were 'not meant to impose a great burden upon a plaintiff,' and that plaintiffs need only plead 'a short and plain statement,' that provides defendants with 'some indication of the loss and the causal connection that the plaintiff has in mind.'"

16:12:35

16:12:56

And you see, as Judge Carr has gone through the Dura test, and as we've just gone through the Dura test, that we've met that "not great burden" here.

Now, you heard that the -- you heard the defendants argue, "Well, wait a minute, wait a minute, wait a minute. The Sixth Circuit in D.E.&J. says you can't plead loss causation here because you haven't shown materialization of the risk."

16:13:13

Lay aside the question of materialization of the risk for a moment. Let's look and see what it was that was defective in D.E.&J. that the court found rendered the allegations ineffective.

16:13:25

And we see that at slide 36, Kevin.

In D.E.&J., Judge Sutton wrote that "The plaintiff did not plead," number one, "that the alleged fraud became known to the market on any particular day," number two, "did

16:13:52

not estimate the damages that the alleged fraud caused," and, number three, "did not connect the alleged fraud with the ultimate disclosure and loss."

Now, we just went through D.E.&J.'s formulation with the Hawaii Ironworkers test. And as you saw, we did allege that the fraud became known to the market on November 20th. And we'll discuss that in great detail in a moment.

We did estimate the damages of the loss cause. That was $6.6 billion. And you see that at paragraph 191 and paragraph 6 in the complaint.

And then, of course, number three, we did connect the alleged fraud with the ultimate disclosure and loss. That connection element is important, and we'll explain why.

You see also -- Kevin, if you could, at 37 -- defendants cited the Almost Family case and the Omnicare case. In the Almost Family case at 37, the court concluded "that plaintiffs must show some revelation of defendants' fraud," just show some revelation of defendants' fraud. That wasn't shown in Almost Family. It wasn't shown in Omnicare either.

You will see that in slide 38, the same language in Omnicare, the Sixth Circuit case, was that "none" -- three lines down, if you are following along, "... none of those allegations explain how the statements were revealed to be false and thereby caused a drop in the stock price."

The question on the Sixth Circuit's mind, it is clear, is: "What statements were revealed to be false and, therefore, caused a drop in the stock price?" And I'd like to talk about that. I'd like to talk about that in the context of these credit risk misrepresentations that I brought up earlier.

If you look at slide 16, this is the definition of "credit risk" as pulled from Freddie Mac's documents. And I'll give the cite, at ECF Number 298-2, page ID 12476. This is slide 16.

Essentially, Freddie Mac defines "credit risk" as "the risk that a borrower will fail to make timely payments on a mortgage or security Freddie Mac owns or guarantees." And, again, to me, that is the question: How likely is it that any given mortgage in this portfolio is going to default?

And we already talked about why it is that credit risk is the top-of-the-line issue for investors, because it's the direct barometer of Freddie Mac's health.

So let's look at some misrepresentations in the credit risk context, and then look at what happened on November 20th to reveal the truth about these misrepresentations.

So let's borrow the Sixth Circuit's standard, let's borrow even defendants' higher standard, and see where

we end up. I will go through these very quickly, because we will do a compare and contrast in a moment.

But if you look at slide 17, this is Defendant Syron, on June 14th, 2007, making a representation that the 16:17:19 second -- the last sentence there, "Thanks to our continued high asset quality, low risk exposures and improving operations, Freddie Mac is much better positioned for long-term profitability than a year ago." Okay. That's three months before the corrective disclosure.

16:17:39 Then you're getting closer, and slide 18, this is August 30th, 2007. This is Defendant Piszel. It says the same thing, the second bullet there: "We have limited and manageable exposure to Alt-A and risk-layered products."

We're getting a little closer there at slide 19. 16:18:00 This is Defendant Cook on September 10th, 2007. The last two sentences there, she is saying, "Our credit position is relatively strong with limited exposure to the riskiest mortgage products." Undefined, by the way. "Bottom line, at a time when many of our competitors are weakening, 16:18:19 Freddie Mac's position is growing stronger."

We can test that, as you might imagine. And this is weeks now -- I'm at slide 20 -- this is weeks now before the corrective disclosure. You have Defendant Cook saying, in response to a question, by the way, about the 16:18:39 top-of-the-line issue: "Tell us how you see credit losses

on your portfolio developing."

Here is Defendant Cook saying, four lines up from the bottom, "We have an incredibly high quality book of business. That's why we have the capacity to take on, in a 16:18:56 diligent and disciplined way, some increased credit risk at a good price." This is weeks, weeks before the corrective disclosure.

And so at 21, I'm not going to review these again, but you see all summarized, you have Freddie Mac making 16:19:11 representations in the weeks and months leading up to the corrective disclosure that credit risk exposure is low; that the credit position is actually better now than it was a year ago, that's September 2007; that, in fact, Freddie's credit position is getting stronger; and that it's so strong 16:19:29 that they can take on all this additional risk, at a good price, she says.

So let's look at what happened on November 20th, because we had a lot of discussion today about "nothing was said in the press release, nothing was said in this November 16:19:45 20th, 2007 disclosure that corrected any of the mistakes."

Well, first -- "misrepresentations," excuse me. Well, first of all, that's not the standard. We saw that the Sixth Circuit question is: Was there a revelation of the truth? Was there a revelation of the truth? Not did 16:20:04 they correct any previous misstatements. Okay. And that's

an important distinction. We'll see why.

On November 20th, 2007, and Your Honor asked the defendants about what it was this corrective disclosure -- where it came from. We have it down there at the bottom of slide 22, that this corrective disclosure upon which we rely is ECF number 290-22, and I will direct the court's attention to page ID number 10991, 10991.

16:20:18

And what this disclosure says is, "We're taking a $2 billion loss 'due to continued credit deterioration in our single-family credit guarantee portfolio, primarily due to 2006 and 2007 loan originations.'" So that's the setup. The setup is, "Hey, we're taking a $2 billion loss related to our credit risk."

16:20:45

Now, for the corrective disclosure on the same date, this is at slide number 23. And for the court's edification, this is the pages 75 and 76 that I think the court discussed earlier. It is ECF number 290-22, and the page ID number, for the record, is 11061-62.

16:21:02

Now, it's a big corrective disclosure. The money aspect of this particular paragraph comes at the end. And here, for the first time, we have Freddie Mac saying, "Consequently, our increased purchases of these mortgages and issuances of guarantees on them expose us to greater credit risks. We expect to experience increased delinquencies and credit losses, which will likely reduce

16:21:27

16:21:48

our earnings in future periods and could adversely affect our results of operations or financial condition."

Here, on November 20th, Freddie Mac has come clean about its credit risk exposure. It is telling the market, "Remember all those things that we said before? They're not true. We have bad credit risk. It's only going to get worse."

16:22:06

So let's go back and compare and contrast. Now, you recall, we just talked about the June 14th, 2007 misrepresentation by Syron. This is at slide 24. You will see that Mr. Syron is saying: "Thanks to our continued high asset quality, low risk exposures and improving operations, Freddie Mac is much better positioned for long-term profitability than a year ago."

16:22:20

16:22:41

Contrast that with what it says here on November 20th: "For the nine months ended September 30th, 2007 and 2006, credit-related expenses were $1.8 billion and $151 million, respectively."

That's not better position for long-term profitability than a year ago. That's exponentially worse than things were a year ago.

16:22:58

Now, let's go to slide number 25 to see this revelation of the truth in action again. Now, here we take Defendant Cook's piece. This is a misrepresentation from September 10th, 2007. And we recall, this is Defendant Cook

16:23:16

saying, "Hey, we have limited exposure to the riskiest mortgage products." And this is the key: "At a time when many of our competitors are weakening, Freddie Mac's position is growing stronger."

16:23:34 That was not the case. And the revelation of the truth happened on November 20th, 2007, where it says: "No, the position is not growing stronger." Second sentence: "We expect to experience increased delinquencies and credit losses, which will likely reduce our earnings in future

16:23:53 periods," et cetera.

This is a direct revelation of the truth of the falsity in Defendant Cook's statement from only two months before.

And I'll give you one more example, Your Honor.

16:24:05 THE COURT: Before you do, let me ask you this, and maybe you can use your next example to clarify.

It's not clear to me that you distinguish corrective disclosure from materialization of concealed risk. And these two have been great examples of how I see

16:24:26 that they are intermingled in your usage, at least as I interpret.

Maybe the third example will help, or after the third example you can pull apart for me so that I know what you are speaking about. Because I would think this next --

16:24:38 this last, what you've shown me on slide 25, may be more

akin to materialization of concealed risk. And I do that to show the surprise, it emanates out of as opposed to corrective disclosure, which I think you used as an example for the earlier slide.

16:24:54 MR. STOCK: It's a fair point, Your Honor. And Your Honor is touching on why -- it's a little tricky in the Sixth Circuit to discuss corrective disclosure versus materialization of the risk, because it appears -- although it's not entirely clear, it appears that the Sixth Circuit 16:25:14 is focused on the revelation of the truth. Okay. While sometimes the courts within the Sixth Circuit use the construction or the construct of corrective disclosure, sometimes courts use the construct of materialization of the risk.

16:25:32 I'm here today to prove that we've adequately alleged loss causation under the Dura standard, as we've discussed with Hawaii Ironworkers, but also -- pick a construct, in essence. We've also alleged a corrective disclosure in the context of the credit risk 16:25:50 misrepresentations.

I will turn my focus, after -- as a matter of fact, after we talk about these revelations of the truth, the construct of materialization of the risk, where the materialization of the risk still, under the Sixth Circuit 16:26:04 law, reveals the truth, reveals the truth about the

misrepresentations related to subprime and the risk management and the underwriting and the core capital, but was not, in fact, a confession of fraud, as defendants attempt to suggest is the standard.

16:26:21 I hope that clarified.

THE COURT: It helps, and I'd like to continue following along with you, keeping that in mind.

MR. STOCK: And so the third revelation of the truth with respect to credit risk disclosures is set forth

16:26:37 here at slide 26. This is Defendant Piszel talking about, again, on August 30th, "... we have limited and manageable exposure to Alt-A and risk-layered products."

The revelation of the truth of the falsity of that statement comes again on November 20th, where defendant

16:26:58 comes cleans and says, "Yeah, approximately one out of every three of our single purchases was related to Alt-A and interest-only loans that related to these risk-layered products." The revelation of the truth occurred on November 20th.

16:27:12 Now, I will concede something. I will concede that on November 20th, there was no corrective disclosure, there was no corrective disclosure, there was no confession of the fraud as it relates to these other -- these other misrepresentations and omissions that I've discussed.

16:27:31 Kevin, if you could put slide 28 up there.

Defendants are right. They didn't come clean with respect to subprime, Alt-A and other nontraditional mortgage misrepresentations, they didn't come clean.

But this goes back to a fundamental misperception of the loss causation standard. What defendants are suggesting to you is that without a confession, there would be no loss causation. And if there's no loss causation, there's no securities fraud.

That is incorrect as a matter of law, and it's actually incorrect as a matter of common sense.

Kevin, if you could go to slide 13.

And, Your Honor, I apologize for jumping all over these slides, but I'm trying to address his arguments in order.

THE COURT: I am following you, so you are doing fine.

MR. STOCK: This is a case out of the Sixth Circuit, similar to the Almost Family case that Mr. Hershman discussed. And I go back to Mr. Hershman's formulation that no confession of fraud equals no loss causation. And I mentioned earlier that this doesn't make sense from a commonsense standpoint, because if it were the case that a defendant could sidestep liability for securities fraud by simply refusing to come clean about any misrepresentations or omissions, there would never be a securities fraud case.

There would never be loss causation. Because all the defendant had to do was stay mum on confessing the fraud.

And, in fact, that's -- this formula of loss causation has been rejected over and over again. Winslow, out of the Sixth Circuit, a Middle District of Tennessee case, I think said it much more eloquently than I did, which is, "If a fact-for-fact disclosure were required to establish loss causation, a defendant could defeat liability by refusing to admit the falsity of its prior misstatements."

16:29:17
16:29:36

And, in fact, if you look at slide 14, one court recently said, "Neither the Supreme Court in Dura, nor any other court addressing the loss causation pleading standard," "any other court," "require a corrective disclosure to be a 'mirror image' tantamount to a confession of fraud."

16:29:52

And you'll see at 15, I'm certainly not going to go through them, there are any number of other cases rejecting that formula as it relates to loss causation.

But I go back to where we started, which was, okay, if there's been no -- if there has been no confession, was there a -- to borrow from the Sixth Circuit, was there a revelation of the truth as it related to these misrepresentations and omissions?

16:30:09
16:30:30

And I think that one way that we might go about

analyzing that question is by looking at the Bear Stearns case. Again, Bear Stearns, it doesn't compel a result here, but it's an interesting case in that it deals with the exact same allegations as are what are at issue here, with an almost identical end of class date disclosure. I'll slip and call it a corrective disclosure, but end of class date disclosure. And so from that perspective, I think it provides some guidance.

16:30:52

And if you look at the Bear Stearns case, this is at slide 31, as I said before, the misrepresentations and omissions are identical -- almost identical. They deal with misrepresentations from subprime and other nontraditional mortgages, misrepresentations concerning risk management practices, concerning internal controls, and concerning compliance with regulatory capital requirements. And I'm not going to go through them, but we've alleged those exact same misrepresentations and omissions in our complaint.

16:31:07

16:31:31

And at paragraph 32 -- I'm sorry. And at slide 32, we have appended all of the paragraphs in the complaint that make those allegations for the court's edification.

16:31:47

Now, I direct the court to slide 33. On the class period end date in Bear Stearns, dealing with the same misrepresentations and omissions, "Bear Stearns announced that its liquidity position had significantly deteriorated, requiring the company to seek financing via a secured loan."

16:32:07

And then, in response to this news, "Bear Stearns' common stock fell by 47.3 percent." That's exactly, exactly what happened here. On November 20th, 2007, in our case, Freddie Mac announced that its credit risk position had
16:32:31 significantly deteriorated, and we just saw that. And then what we didn't look at, but Freddie Mac also informed investors that it would be seeking a loan, potentially, to shore up its credit position, and would be cutting the dividends. We have the exact same thing pled as to Bear
16:32:46 Stearns.

Now, what Bear Stearns didn't say, by the way, is the class period end date, Bear Stearns didn't come clean with respect to its subprime and nontraditional mortgage exposure, or its risk management practices, or its core
16:33:02 capital problems. It didn't come clean with respect to those. It was this indication of the deterioration of its liquidity position that revealed the truth related to those other misrepresentations. And you will see how the court dealt with that issue at 34.

16:33:21 Again, I don't want to read this to the court, but the point is, the same thing happened that I just discussed. When the liquidity position was revealed, the truth regarding the previous misrepresentations, about subprime, about risk management, et cetera, were also revealed to the
16:33:43 market, also -- "Defendants' conduct" -- this is the last

sentence there, "Defendants' conduct, as alleged herein, proximately caused foreseeable losses and damages to Lead Plaintiff and members of the Class."

Well, look at, if you will, slide number 10. Slide number 10 alleges those very words, very words. You see the last sentence -- and I promised you, Your Honor, I would not read you paragraph 271. I guess I broke my promise to the extent that I would like to read you the last sentence there. And it says -- remember the Bear Stearns decision -- "The fraud perpetrated by the Defendants described in this Complaint proximately caused foreseeable losses to the Plaintiff and the other members of the Class."

There has been adequate allegation of loss causation here. Whether it is under Hawaii Ironworkers using the Dura standard, whether it is under a corrective disclosure rubric, whether it is under materialization of the risk, the point is, the revelation of the truth -- to borrow from the Sixth Circuit, the revelation of the truth occurred on November 20th, with respect to credit risk, subprime, nontraditional, Alt-A, risk layering, underwriting standards. That was all revealed by this catastrophic decline in the credit position, just like Bear Stearns.

Now, you heard Freddie Mac suggest, "Well, wait a minute, Central States has already given you this answer." I am mindful of the court's admonishment not to talk about

Kuriakose and Central States, but I will say one word about it.

If you look at slide 41, Central States says, "At the outset," so at the very beginning of the decision, the 16:35:40 court says, "we note that on November 20th, 2007, the first day of the class period, Freddie reported a loss of more than $2 billion, causing its stock price to close -- stock price to fall," as we've discussed.

"On the same date, Freddie Mac issued a supplement 16:36:04 to its 2006 Annual Report disclosing both its increased involvement in nontraditional mortgage markets and the 'greater credit risks' from 'increased delinquencies and credit losses' involving nontraditional mortgage products," and then it goes on.

16:36:22 The entire decision in Central States is framed by what it says, "At the outset," which is, "Hey, guys, caveat emptor at this point. On November 20th, the fraud was out on the market. If you were going to buy into that position, if you were going to buy into Freddie Mac after November 16:36:41 20th, caveat emptor."

That is entirely consistent with what we're saying, because November 20th is the last day of our class period. And we're saying, on that day, investors were taken by surprise. They were taken by surprise. They weren't 16:36:57 ready for it. That's quintessential loss causation.

Central States isn't a barrier to pleading loss causation in our case, it's a helper. It helps us plead it. It shows why we've pled it correctly.

The next thing that I heard Mr. Hershman talk about was that they told everyone that they were getting into nontraditional loans. And, "We told everyone."

And that's not the case. And, in fact, whether it was the case or wasn't the case, it's certainly a fact issue not relevant at the motion to dismiss stage.

16:37:34 You know, our allegation is, "Hey, defendants lied about their exposure to nontraditional risk." Defendants say, "No, we didn't lie about it, we told the truth about it." The Ganino case that we've cited at 48, and a number of other cases that we've cited there, all suggest that when 16:37:52 you have these truth-on-the-market questions, when one party says, "The light is red," one party says, "The light is green" in the securities context, that's an issue for summary judgment. It's really an issue for trial, but that's at least an issue for summary judgment, not one to be 16:38:09 dealt with at the motion to dismiss stage. But also, if the court would indulge questions of truth on the market at this stage, they're not even correct.

If you look at slide 49, I'll explain why. Slide 49 says, "At year's end, only 6 percent" -- this is -- 16:38:29 excuse me. This is Defendant Syron talking in the 2006

annual report. And I'll try the quote again. "At year's end, only 6 percent of our total mortgage portfolio was in nontraditional mortgages and the portfolio's average loan-to-value ratio was 57 percent."

16:38:46 Now, the truth, we put down a little bit lower, was, in fact, at year's end, 11.1 percent of the total mortgage portfolio was in nontraditional mortgages; not 6 percent, 11.1 percent, almost 100 percent greater than what they're representing to the market.

16:39:05 Now, we must have struck a nerve with Freddie Mac, because Freddie Mac takes us to task in the reply brief on this point. And you'll see that at 50, at slide 50.

Freddie Mac suggests: "Plaintiff also improperly contrasts facts relating to what are, on their face, 16:39:27 different portfolios in an effort to manufacture a discrepancy." And I skip over a couple sentences. "Further, the total mortgage portfolio is obviously," "obviously," "the total of all of Freddie Mac's mortgage portfolios, not just the single-family portfolio, and 16:39:48 Plaintiff should know better than to conflate the two."

Well, we weren't conflating the two. And, in fact, you don't have to take my word for it, you can take Defendant Syron's word for it, because Defendant Syron gave us a clue in his statement that, in fact, he was talking 16:40:01 about only the single-family portfolio, not all of the

portfolios.

Let's look back at Defendant Syron's statement for our clue. I am not going to read it again, but there's Defendant Syron saying "6 percent of our total mortgage portfolio," and then at the end is the clue, "the average loan-to-value ratio was 57 percent."

16:40:18

Well, in fact, in this very annual report, there is a table that discusses the characteristics of the single-family total mortgage portfolio. That's at slide 51. And you see there at the top, we say "Syron Was Talking About the Single-Family Total Mortgage Portfolio," because there it is, the estimated LTV ratio is 57 percent. Plaintiffs weren't conflating these two; plaintiffs were just talking about what Defendant Syron was talking about.

16:40:40

16:40:58

And the point is, Defendant Syron's representation to the public is that "Hey, we've only got 6 percent of nontraditional mortgages in our portfolio." In fact, it was 11.1 percent.

Mr. Wayne will discuss why Defendant Syron and the rest of the defendants knew these things. And although I don't have a watch with me, I expect that my time has grown short and I will allow Mr. Wayne to come up and do that, unless the court has any further questions.

16:41:13

THE COURT: No, not at this time. I might for Mr. Wayne.

16:41:26

Counselors, I am going to take a brief break. I've received two notes from the jury, and I think I can handle both without bringing them into this room, especially since the last one is a request that they be allowed to leave for the day.

16:41:39

I am going to try to handle that matter as expeditiously as possible, but I will ask that you give me at least ten minutes. So to the extent you can benefit from a ten-minute break, you have the same break.

16:41:52

We're in recess.

(Recess at 4:41 p.m., and the proceedings resumed at 4:53 p.m.)

THE COURT: Are we reassembled?

Mr. Wayne?

16:53:19

MR. WAYNE: Mr. Stock had one additional point he wanted to make that goes to his report. Thank you.

MR. STOCK: Your Honor, I come up here sheepishly and apologetically. Mr. Markovits instructed me that I should discuss this, and I have a four-and-a-half-hour drive

16:53:36

home with him, so for my sanity, I am here to present one last slide to you. That is slide 46.

This is what happened empirically on the last day of the class period. This is a collection of financial industry folks who -- and I should preface by saying that

16:54:02

slide 45 has the cite data, the data populating this chart.

It comes from ECF number 79-17, at page ID 3049 to 50. The numbers from this chart don't come out of thin air, in other words.

You will see that on the day of these disclosures, the blue, the blue is what the industry expected would be the change as a result of the housing crisis. So the housing crisis is hitting all of these -- all of these financial sector companies significantly, and in relatively the same way.

And I would be remiss if I didn't show you that in slide 45, the dates all come from the same time period, the same three- to four-month time period. The losses and write-downs are all nearly equivalent. But the excess return -- and the excess return is sort of a term of art that means the difference between what the market expected and how the stock dropped.

The excess return for all of these other financial industry companies that were hit in the same way by the housing crisis, to the same magnitude by the housing crisis, you see an excess return of .39 percent. You know, that means they bested industry expectations by, you know, four-tenths of a percent, or down 1 percent, et cetera, et cetera, 2 percent, 4 percent.

But Freddie Mac's excess return, that is the difference between the expectation of what would happen on

November 20th and what actually happened, the excess return was 28 percent. That's empirical evidence that the market had not factored in the extent of the housing crisis, in the same way that the market had factored in the extent of the
16:56:07 housing crisis with respect to all these other financial institutions. You can see it. The proof is in the pudding there in that excess return category on 45 and in 46.

And Mr. Markovits reminded me that we presented this chart to the court five years ago. Mr. Markovits also
16:56:28 presented this exact chart to Your Honor a year ago, when we were here first discussing Freddie Mac.

And at that point, Mr. Markovits made the same comment that I'm about to make. Mr. Markovits challenged Mr. Hershman and said, "What is it in these disclosures that
16:56:46 makes all the rest of these financial industry participants different than Freddie Mac? Why did the excess return in the case of Freddie Mac exceed any of these others by such an extraordinary magnitude?"

And the answer is: Because the truth had not been
16:57:04 revealed to the market prior to November 20th in the way that the truth had been revealed to the market with respect to all these others.

And I'll say the same thing Mr. Markovits said. The first time we hear an explanation for that will be in
16:57:19 reply here today, and the plaintiff looks forward to it.

Thank you.

THE COURT: Thank you.

Mr. Wayne, by my clock, you probably have something around 12 minutes now.

16:57:41 MR. WAYNE: I will talk fast. Not as fast as Mr. Kravitz, but I'll talk fast.

THE COURT: I don't know why that's the suggested response. Say less.

(Laughter.)

16:57:52 MR. WAYNE: I'm only teasing.

THE COURT: Just off the top of my head. But in any case, I will hear you.

MR. WAYNE: Well, thank you, Your Honor.

As Mr. Stock said, what I am going to talk about 16:58:05 is the issue of scienter, and we've already talked about the law in the Sixth Circuit, PR Diamonds, and the Supreme Court law in terms of Matrixx and Tellabs, in terms of the holistic view.

What I want to do is talk about a couple of things 16:58:21 I think are important, scienter, and then I want to make sure -- I will move quickly, because then I want to make sure I address a number of things that were raised by defense counsel, many of which are in our brief, but there's a couple I want to make sure I cover.

16:58:35 I think the first thing is to make sure that we

understand that any analysis starts with looking at the positions of the defendants, because these individual defendants, we have claims two ways against them.

One, we have a direct claim as a direct perpetrator, a primary perpetrator under 10b, and we also have a claim because of their position, a control position under 20a of the 1934 Act. So there are two sets of claims here in terms of how you could get liability against the individual defendants.

But in terms of dealing with the issue of analysis of scienter and their access to information and their positions with the company, it's very important to look at what -- we know Mr. Syron was the chair- -- Mr. Syron was the chairman of the board. We know that he sat on a number of committees.

The one important committee I'd like to talk about is the Enterprise Risk Management Committee, the ERMC. And that's a committee that was tasked with looking at the credit, the market -- I should say the risk, the credit risks, the market risks and the operational risks of the company. And that's where a lot of the discussion took place in terms of the risks of getting into subprime, the dealing with the underwriting type of mechanics and standards as well, and fraud detection and things like that, whether or not they were really being maintained.

And, you know, when you look at it, every one of these individuals was in a position of control. Every one of them had a responsibility to make sure the financial information was correct. Every one of them attended the ERMC meetings.

17:00:17

Now, Mr. Piszel didn't start attending those meetings until 2007, but he attended all of those meetings. And in our complaint, which I'll talk about in a minute, those meetings are where the risk, the market and credit risk were discussed.

17:00:32

After you do that, in looking at that, then you look in terms of -- in terms of scienter, you look in terms of, what knowledge did they have, the individual defendants, and whether or not that knowledge was con- -- contradicted the statements that they made.

17:00:51

And when you look at that, what you find with these individuals is that they had information, and the disclosures that they made weren't complete, weren't fulsome, and we don't believe that they complied with the '34 Act, 10b-5.

17:01:08

And if you look at it to start with, I'd like to have -- this is a -- it's Docket 302-3, FMAC 082819602. And this is from the Freddie Mac -- the Freddie Mac -- the ERMC -- I'm not doing this right. I don't know if you can see that.

17:01:48

THE COURT: I can pretty well.

MR. WAYNE: Okay. This is one of the EMC meeting -- the ERMC meetings, and this is a meeting that Mr. Syron, Ms. Cook and Mr. McQuade attended. This comes out of the materials that are presented every month.

17:02:03

And what it says here, in talking and addressing the expansion -- and this is in June of 2006. It was shortly before the class period, and they were already talking about getting into the high-risk mortgages.

17:02:23

It talks about "Purchase and guarantee of higher risk mortgages, both in structure and underwriting standards, from nontraditional sectors is expanding faster than our ability to develop requisite risk management and control capabilities. Factors driving our concern include:

17:02:41

Increase in waivers and exceptions, our ability to fully identify, track and evaluate them, a paucity of performance data on higher risk products, and internal and external data integrity issues."

What's important is that this is at a period of

17:02:57

time when they were -- the company was talking about, and they knew they were going to get -- they were going to relax the underwriting standards, they were going to get into this high risk, higher risk subprime mortgage area, nontraditional mortgage area. And this was the beginning of

17:03:11

it.

There's a very similar one from October 3rd, 2006. I will put this one up as well. Maybe just to save time, I will go through it. But it was on the October 3rd, 2006 ERMC report.

17:03:34 And in this one, it's in the month- -- it comes in a monthly packet, goes to all the individuals -- all four of the individual defendants, and talks about the current risk concerns of the company.

And the page I'm referring to is FMAC 082820934.

17:03:55 And in this, it says that -- in talking about the risk description -- "We are approaching management-approved risk limits for both relative risk and alternative mortgage products. The market continues to produce mortgages with higher risk profiles. Our strategy of buying representative

17:04:14 market share pushes purchase and portfolio activities towards the limit. We have limited capabilities to transfer risk."

And it goes on and talks about the assessment and the trend, and it said, "It's high and rising. The

17:04:27 portfolio rebalancing may be necessary."

So at this point in time, we're talking about June, October, we go to as well, they're continuing to talk about reduced underwriting standards and getting into this higher risk area.

17:04:39 These continue on. You know, there is a January

2007, January 18th, 2007, which we allege in the complaint at paragraph 119. That is another meeting where this was discussed. Syron and Cook attended this meeting and were told that "Loan level risk rates are blurred as capital retreats in the subprime market, increasing the likelihood we are already purchasing subprime loans under existing acquisition programs."

17:05:01

This is a warning they gave to the members, that management gave to the members of this committee, all of these four individuals. And this warning was in -- from that point on, was in every packet that the ERMC received going forward after January of 2007.

17:05:16

This is significant, because it shows that all of the individual defendants attended this meeting. It shows that they all -- they understood what they were getting into, and that that was something that the company was going to pursue.

17:05:32

It goes on, in the next meeting, in the complaint at paragraph 132, and this is a meeting that just Syron and Cook attended. They were told at this meeting, and they're again talking about these high risk, non-prime mortgages, and they said that -- they were told that the defect rate of purchases had been steadily rising, had increased from approximately 13 percent at the end of June of 2007 to 19 percent at the end of July, and they went up to 22 percent

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in August.

They were also told that the principal drivers for this was the -- and the defect rates were the low FICO scores -- the drivers of the defect were the low FICO scores, which is a predictor of whether or not someone can pay, and the high LTV values, which was the loan-to-value ratios, it was very high.

17:06:32

So, you know, and these are facts that they knew. They all knew that -- all four of these defendants knew that they were getting into this particular type of product.

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And then we take a look at -- in the complaint at the various statements. We know that they know about getting into this, we know that underwriting standards are going down, and now we are moving into what they say in terms of the statements.

17:07:05

In the complaint, there is a paragraph 151. We talk about, this is where Mr. Piszel attended a market update conference in January of 2007, talking about these. He said, "Freddie has continued to display very low and well managed interest rate and credit exposure."

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Then there was a conference that's referred to that Mr. McQuade attended, and that's referred to in paragraph 153 of the complaint. That's on February 8th. That's a Credit Suisse conference.

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And he made a presentation. At that conference,

he says that Freddie maintained very low interest rate and credit risk exposures throughout the year. He said Freddie had consistently stable credit and interest rate risk exposure, and that Freddie's current credit risk measure remained within or below historical rates.

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These go on. There is another conference on May 14th of 2007. That's a UBS conference that Mr. Syron attended. And instead of talking about the risk at that particular conference, he stated that "Freddie Mac had achieved its growth by maintaining a disciplined approach in underwriting credit risk Freddie Mac takes on." He also indicated that "Freddie Mac's disciplined approach of credit underwriting and Freddie's high asset quality has put Freddie in the position to make the commitment that it will not chase growth at the expense of long-term shareholder returns."

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These were -- Ms. Cook was at a conference, a Lehman conference, and Mr. Kravitz talked about in May, made the same comments again. And they didn't disclose in any of these -- they continued the refrain of talking about being in low credit risk products, talking about their disciplined credit underwriting.

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But at this time when they're making these statements, they knew precisely the problems, and the fact that these were high risk types of loans, and they didn't

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make full disclosure.

And when you look at the securities laws, the securities laws require, once you have this information, you're required to make full disclosure of all the information. And you have to look at it in context.

And I think that's why the Supreme Court talks about it in terms of a complaint has to be considered holistically. You can't take out one particular statement, you have to look at all the statements. If you're talking about a particular class period from, like, August of '06 to November of '07, you have to see the pattern of disclosures over the period of time.

So, and that's the one area talking about the particular risk.

The second area I'd like to talk about is their subprime exposure. There's a lot of allegations in the complaint -- I mean, it's 125 pages -- in terms of what was being said at the time. But their knowledge, again, goes back to the ERMC.

In the ERMC reports, beginning early in 2007, paragraph 119 alleges that Freddie Mac indicated that it was "already purchasing loans with credit risk characteristics similar to subprime loans originated by self-identified subprime originators under their -- under their existing acquisition programs."

You know, we've heard about this definition, you know, that their definition of subprime was subprime that came from particular originators of subprime loans.

You know, they don't say that. That's not -- if 17:10:34 you look at paragraph 182 of the complaint, it talks about subprime being high-risk loans. It never talks about subprime, you know, being some loan that comes from a subprime originator.

And, in fact, that was an issue that came up in 17:10:49 the SEC versus Syron case. You know, in that case, when Judge Sullivan is talking about the issue of scienter as to Mr. Syron, he says -- he's talking about the allegations, the same thing we've gone through here, the ERMC reports, the senior management meetings, and he talks about, after 17:11:09 reviewing the statements that were being made in terms of talking about subprime, he said at the -- he says that "These allegations establish an inference that Syron knew the term subprime could be used to describe loans with high credit risk, that he knew Freddie Mac was already acquiring 17:11:28 such loans, that he knew Freddie Mac classified such loans as caution loans, and, thus, he knew that or was willfully blind to the risk that sweeping statements like 'We have basically no subprime exposure in our guarantee business' and 'We didn't do any subprime business' would mislead the 17:11:52 investors."

And that's exactly the very -- the similar pattern of allegations are in our complaint. That's what happened. You know, we go through the information at these meetings where they're talking about subprime being high risk, and what they're purchasing.

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And then when you get into the disclosures that are made, you see that the disclosures that are made -- for example, on February 27, 2007, Mr. Syron -- after the financials come out for the year, Mr. Syron was interviewed.

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And in the interview, he falsely assured the public that Freddie Mac, in his words, "had virtually no credit exposure to subprime mortgages and mortgage-related securities backed by these loans."

The complaint also alleges that, in paragraph 161,

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Mr. Piszel, at an earnings conference on March 23rd, when asked about Freddie Mac's involvement in the subprime, falsely stated that "We, Freddie Mac, have little to no exposure to the subprime, risk layered and mortgage products that have drawn so much note recently."

17:13:02

Similar statements were made by Mr. McQuade when he was interviewed by *Bloomberg News*.

So, in this pattern, when you say subprime in the way he said it, "We have no exposure to subprime," he had a duty under the securities laws to say what it was, to tell

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the market what he meant by that.

If he meant that it was all non-prime, he should have said that. If he meant it was just the C1, C2 and EA loans, he should have said that as well.

But the sweeping statements, the sweeping statements were insufficient to let the market have the entire information that they're required to have under the securities laws.

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THE COURT: Let me stop you for just one minute --

MR. WAYNE: Sure.

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THE COURT: -- to ask your position. I'm referring to the Sixth Circuit's language in Frank v. Dana, a 10(b) action --

MR. WAYNE: Right.

THE COURT: -- when it speaks about -- it gives

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guidance about what a court should be looking at when trying to decide a 12(b)(6). And I won't read it all to you, but just to acquaint you with where I want you to be. All right?

"First, all of plaintiffs' factual allegations

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must be accepted as true." Nothing unusual.

"Second, the complaint and other sources should be considered in their entirety." That's what I think we've spoken about the holistic.

MR. WAYNE: Holistic, collectively, yes.

17:14:21

THE COURT: Yes. "Third" -- so I'm jumping down a

bit now that I think you are where I want you to be.

"Third, the court must take into account 'plausible opposing inferences' when determining whether there is a strong inference of scienter. A complaint will survive 'only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.'"

What I want to speak to you -- or you to speak to me about is the opposing inferences. My interpretation of that language is that the inference of scienter must be at least as strong as the opposing inferences.

So I am certainly not disagreeing that there's at least inferences of scienter in the vein that plaintiffs have argued.

MR. WAYNE: Right.

THE COURT: But there are also the opposing inferences.

MR. WAYNE: That's right.

THE COURT: And some of those have been alluded to, the disclosures that have been made.

Can you say anything to better inform me or just share your position about -- and I don't want to be so broad as to say the weighing of --

MR. WAYNE: Well, I think that's what it comes

down to. I think that's kind of what it comes down to.

THE COURT: In part, right.

MR. WAYNE: In the sense that they have to be equal. One doesn't have to be better than another, but ours has to be our -- a reasonable person with this series of facts has to be able to weigh them in the nature of being equal, equally --

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THE COURT: And your inferences have to be at least as strong as the opposing?

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MR. WAYNE: They don't have to be stronger --

THE COURT: Right.

MR. WAYNE: -- but they have to be at least as strong.

THE COURT: Right.

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MR. WAYNE: That's correct. And that's what the law -- the Supreme Court has said that as well.

THE COURT: And your position is you meet that?

MR. WAYNE: Oh, I think we meet it by far. I think -- yeah. We're talking about in terms of pleading

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information. You know, we heard about the Kuriakose case earlier today in the sense of saying, "Well, this case is just like Kuriakose."

Well, it's not like Kuriakose. I mean, Kuriakose, the class period begins on the day our class period ends.

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We say disclosure is made on November 20th, 2007. That's

the day the Kuriakose claim begins. That's the beginning of their class period.

So I think you've got to look at these kinds of issues, and I think that when you look at, you know, those inferences, it's got to be -- it's got to be equal.

THE COURT: Okay. Fair enough. Thank you for that. Are you wrapping up?

MR. WAYNE: Yeah. I just want to -- I think a lot of these points have been --

THE COURT: I'll give you the time to wrap up. I stole a moment from you.

MR. WAYNE: Okay. I just want to go through just a couple of -- unless the court has any other questions.

THE COURT: If I do, I'll speak up.

MR. WAYNE: I think that I'm -- just briefly, in terms of Ms. Cook, I think her subcertifications, I think the position she had with the company, I think being at every one of these ERMC meetings where the risk was discussed and subprime was discussed, and she had that information, went to the market and made statements that said they had basically no exposure, I think puts her in the position where she's a primary perpetrator under 10b-5. If not, she would be included under 20a as a control person.

You know, I think that -- everybody is talking about the stock sales. That's certainly one of the elements

that -- or one of the elements that Helwig talks about in the Sixth Circuit. You know, but nobody talked about the fact that the compensation here was basically -- the large parts of the compensation here was basically performance-based, hitting the targets in terms of their portfolio.

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And, in fact, in 2006, 80 percent of the compensation of these four individuals came from compensation through performance-based compensation. It wasn't just direct salaries, they made more for reaching these target levels. So that's a factor under -- because Helwig says, "I'm going to give you a list of nine factors. These aren't exhaustive, there are other measures." When you're looking at interest in terms of what people are making, I think that's a factor you have to look at as well.

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Stock losses. Piszel. Piszel, the same thing, in terms of they said there was no scienter. You know, they talked about the statements that he made. I think that he was at those meetings, the ERMC meetings where the risk was talked about, where subprime was talked about, starting in 2007. I think he had the knowledge of that information. I think he had a duty to speak completely in terms of what he had to disclose under the securities laws, and I don't think he did it.

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McQuade we've talked about. I've gone through

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McQuade's. And Syron we've gone through as well.

I have nothing further, Your Honor, at this point based upon my time being up. But if there's any other questions, I'd be happy to answer them.

17:18:51 THE COURT: Let me ask you this: And I ask it as I have all my questions, not intending to augur any result, but just to ask this question.

You heard, and I think it was Mr. Kravitz, who said that he believed the case should be dismissed with

17:19:06 prejudice, and essentially said, "Plaintiffs can't fix this. They've had," I think he said, "four chances at it now," and if there are three amendments and the original complaint, then I guess that is four.

Do you agree -- I'm not asking you to agree that

17:19:21 it should be dismissed. Obviously, you are stridently against that.

Do you agree that you've done your bona fides; if this third amended complaint doesn't satisfy the court, then it deserves a respectful burial?

17:19:35 MR. WAYNE: I say this with all due respect. That's a catch-22 question. You know, on one side I can say that "Well, depending upon how the court rules, we may be able to fix it."

THE COURT: Uh-huh.

17:19:45 MR. WAYNE: You know, but on the other side, I

will tell you that I think in terms of the pleading requirements, in terms of a 10b-5 claim, in terms of the disclosures that were made here, based upon the information that was available, when you contrast that with the
17:19:58 disclosures which were made, I think there is a strong inference of scienter here that would allow us to proceed with this case.

THE COURT: Thank you, sir.

MR. WAYNE: Thank you, Your Honor.

17:20:07 THE COURT: Rebuttal?

MR. HERSHMAN: Your Honor, the first point I want to make is based on something that Mr. Stock said, and it's this: A securities fraud case turns on the actual statements made by the defendants themselves, not on the
17:20:38 plaintiffs' characterizations of what they said.

And it's very important, and I know the court will be very careful in actually looking at what the defendants actually said, or what the documents actually say as compared to anything that's been on slides today or been
17:20:52 represented to you. And I say that in particular because of one of the points that Mr. Stock made which was related to his slide 49, where he took to task the defendants in our briefing.

And, in particular, in his slide, which I don't
17:21:07 have in front of me, but you may have -- it's in this

record, he pointed to argumentation, and he said -- he pointed to a statement in their brief, "At year's end, only 6 percent of our total mortgage portfolio was in nontraditional mortgages, and the portfolio's average loan-to-value ratio was 57 percent." And then he said, quoting our briefing, then he comes down and he said -- it says, "The truth is that at year end, 11.1 percent of the total mortgage portfolio was in nontraditional mortgages."

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Now, what he left out in referring to our briefing is the following statement in our brief at page 34 of our reply brief: "Even a cursory glance at Wayne Exhibit 9, on which plaintiff relies, makes clear that the 11.1 percent figure refers to 'untested mortgage products' not 'nontraditional mortgages.'"

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Now, the reason that that's significant is because these things are different. You have to look at the documents. You have to be very careful about what it is that they actually say.

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Now, what I next want to focus on is the issue of loss causation. And Mr. Stock has asked this question: "Why did Freddie Mac's stock price drop this day in a greater amount than expectations as compared to other companies?"

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Well, first of all, the law regarding whether or not loss causation is adequately pled has nothing to do with

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the size of a stock drop. The fact is that the stock drop in, for example, D.E.&J. is 60 percent, and the Sixth Circuit affirmed the grant of a motion to dismiss in that case saying that loss causation wasn't adequately pled.

17:22:49 Stock prices drop a lot whenever the market hears information that is surprising that day. Every single securities fraud class action, every one deals with a big stock drop that triggered a case, and every case where loss causation is the basis that the case is thrown out is

17:23:09 concluding, yes, the market was surprised that day by what it heard, it triggered a big stock drop, but there's nothing to show that that was the result of the revelation of the fraud, the falsity of a prior challenged statement.

Now, here where Freddie Mac is a monoline company

17:23:25 that is only invested in home mortgages and mortgage-backed securities, it isn't surprising that in the midst of one of the largest declines in real estate values and recorded history, it would react more negatively to the falling real estate market than a bunch of companies that have a lot of

17:23:42 other parts of their business, not just real estate loans and securities backed by real estate loans.

THE COURT: Are you telling me then that the others on slide 45 are not monoline like Freddie Mac?

MR. HERSHMAN: I don't believe so. I don't

17:23:59 have -- they're a bunch of investment -- I don't have it in

front of me, but --

THE COURT: You don't have it?

MR. KRAVITZ: Yes.

THE COURT: Thank you, sir.

17:24:06 MR. KRAVITZ: Yes, Your Honor, you are correct, they are companies with a wide variety of businesses.

MR. HERSHMAN: You've got Morgan Stanley, Citigroup. These companies are -- Freddie Mac, by law -- Bank of America, Bear Stearns. These are large investment 17:24:20 banks that have many parts of their businesses whereas Freddie Mac, by law, can only be invested in home mortgage -- you know, home mortgages or securities backed by home mortgages, period.

I want to talk a little just for a second about 17:24:33 the law as it relates to loss causation. And I'll be very quick on this, but I will use my demonstratives quickly.

So, first of all, Mr. Stock referred repeatedly to the revelation of truth. I don't know what he means exactly, but this is Omnicare, this is the Sixth Circuit, 17:24:57 and here is the language of the Sixth Circuit: "The complaint failed to 'explain how the statements were revealed to be false and thereby caused a drop in the stock price.'" There has to be a revelation of the falsity of the challenged statement, and that's not what's present here.

17:25:17 THE COURT: Well, you heard what he also said. He

said, "Well, if we have to wait for a revelation when there's certainly motivation to keep secret that which caused the loss, then there'd never be a securities case."

MR. HERSHMAN: Well, and it's not that there is -- and I'm relying here on the law itself.

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THE COURT: I appreciate that.

MR. HERSHMAN: It's not that there is a requirement that there be, quote, unquote, "a confession."

But the fact is, under these cases, it has to be the case that somehow the market learned of the falsity of the challenged statement, and that, accordingly, the fraud caused the loss, the revelation of a fraud caused the loss. And that's because if it weren't for that, then it would just be a windfall.

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If there was no revelation whatsoever of fraud, it would simply be that -- if you created a cause of action for that, it would just be -- as the Supreme Court said in Dura, it would be investment insurance. If the loss has nothing to do with the revelation there had been a fraud, then there's just a windfall to the plaintiffs' class.

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So the law is very clear that it has to be the case, under Omnicare, under D.E.&J., under Dura, under Lentell, every one of those cases makes clear that it has to be the case, as of the end of the class period, there has been something that has revealed the falsity, in the

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language of Omnicare, the falsity of the challenged statement, which thereby caused the drop. I think that's literally -- that's literally the language of the case: "How the statements were revealed to be false and thereby caused a drop in the stock price." That's the governing law of the Sixth Circuit.

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Now, on the issue of subprime and loss causation, Mr. Stock made a -- frankly, a candid but stunning and very important concession, which is, there is nothing that is disclosed on November 20th, 2007, that reveals the alleged falsity of any statement regarding the quantity of loans in Freddie Mac's guarantee portfolio.

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So quite specifically here, and I'll talk in a minute about the statements, Mr. Syron saying, "We essentially have no subprime in the guarantee portfolio." Let's just presume for a second that that's a misrepresentation, which we do not concede, and which Judge Keenan held wasn't even a misrepresentation, let alone one that was made with scienter.

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But even if it was, there is nothing that came out on November 20th, 2007, as Mr. Stock conceded, that revealed that there was anything inaccurate ever said about the quantity of subprime, "subprime loans," however you define them, in the guarantee portfolio. And their own statement is saying here it was off by 12 percent. And that exact

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number is drawn from information that was first revealed to the market, according to them, in 2011, which is four years after the class period ended.

We dispute the notion that these aren't subprime loans, which I'll talk about. But even if they were, there's no loss causation, which is exactly what the Second Circuit held in Central States on that exact allegation, applying the exact case, Lentell versus Merrill Lynch, on which the plaintiff relies.

Now, as far as their attempts to distinguish Central States, I'm just going to come back to what I said before. And you can cross-reference my chalks to their exhibits. If you look at the decision in Central States, the court doesn't say, "On November 20th, this was the first time Freddie Mac said this." And the Second Circuit doesn't say, "The fraud was revealed on November 20th, 2007."

They simply say, "On November 20th, 2007, there was information disclosed that day of the sort that they point to." And they say there was a stock drop that day. Now, and that's true. They don't say that it's as a result of fraud or the revelation of any -- that any statement made previously was false.

And, the fact is, there was bad news that happened, and that kept on happening, as home price values kept going lower and lower and lower, which caused

unavoidable losses at Freddie Mac. No one had a crystal ball. I mean, we've cited in our briefing before pronouncements by the treasurer of the United States and all sorts of folks in the middle of the year of 2007, in the summer of 2007. People didn't know that it was going to get worse, and then worse, and then worse. People don't have a crystal ball.

And in a second, I will focus on their supposed alleged misrepresentations by Ms. Cook and Mr. Syron, which were right after the second quarter results were announced. They were talking about the results for the second quarter. You have to go and look and see the context of the statements that they're pointing to. When are these statements being made? Freddie Mac announced its results for the second quarter on August 30th, 2007. They are at conferences literally in the next week talking about Freddie Mac's results for the second quarter of 2007.

There is nothing that was revealed at the end of the third quarter of 2007 that showed that what they said about where Freddie Mac stood as of the end of the second quarter of 2007 was false when it was made.

What did happen is the real estate market got much worse, and kept getting worse afterwards. But that doesn't mean that what they said after the end of the second quarter, where there wasn't a big stock drop after the

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announcement, was false when it was made. It was just that things got worse.

Now, there's a very famous case that talks about that. And it's a line that comes from a Seventh Circuit case called DiLeo. And I'll just -- it's in our -- we refer to it in our briefing at -- I think it's our reply brief at page 27. And --

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THE COURT: Those numbers at the top of the page you have --

MR. HERSHMAN: Ahh.

THE COURT: -- that's the secret.

MR. HERSHMAN: For you, isn't it? What, a page ID number?

THE COURT: That would help, yes.

17:32:05

MR. HERSHMAN: 12183. And the quote is as follows: It's from the DiLeo versus Ernst & Young case, a very famous securities case. "The story in this complaint is familiar in securities litigation. At one time the firm bathes itself in a favorable light. Later the firm

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disclosed that things are less rosy. The plaintiff contends that the difference must be attributable to fraud. 'Must be' is the critical phrase, for the complaint offers no information other than the differences between the two statements of the firm's condition. There is no 'fraud by

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hindsight,' and hindsight" -- you know, and that's the issue

here.

Those kinds of allegations, Mr. Stock is simply putting up a bunch of statements made after a quarter that was successful. And then there's another quarter and it's not successful, and that's because market conditions changed and they reported a loss. That doesn't show that what they said earlier was fraudulent or false when it was made.

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Now, getting back to this point I want to just close out on, those allegations that are the basis for their distinction of Central States; and the same with Mr. Wayne talking about, do you see these internal dockets, where they're talking about how they're getting into these nontraditional mortgages in 2006?

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Never mind 2006; I am showing you 2005. Those internal documents are completely consistent with what Freddie Mac has been publicly stating for years. If the court compares the disclosures on which Mr. Stock focused, on November 20th, 2007, and the portion of Central States that quotes part of the disclosure from November 20th, 2007, and compares it to the same sections of numerous other disclosure documents that we've cited, the court will see that that's not the first time Freddie Mac said it. Freddie Mac said it going back to 2000 and -- I just started in 2005. Those disclosures go back even further than that, before the class period even began.

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They told investors, "We are going to be buying more of these nontraditional mortgage products. They are riskier, relatively speaking, to the more traditional ones. They are going to default at a higher rate. This is new for us. This is different for us. These are mortgage products of specific types we haven't been buying before, interest-only loans, option ARM loans. And that's new. That's a new thing for us. It gives rise to new risks. If you don't like it, if you don't like those risks, this is the way the securities laws work, don't buy Freddie Mac stock."

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But it is not accurate to say that Freddie Mac disclosed that information for the first time on November 20th, 2006. It is simply not so.

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Let me just run quickly through what I have here, Your Honor.

THE COURT: And you meant November 20th, '07? You said "'06."

MR. HERSHMAN: I'm sorry, November 20th, '07.

17:35:20

Now, I do want -- Mr. Stock also referred to what Freddie Mac said in its disclosures about its subprime holdings. And I just want to read to you exactly what Freddie -- so I guess, full stop, the plaintiffs have conceded they haven't pled loss causation as to the subprime allegations.

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And I am saying to you that as to the credit risk allegations that they pointed to, there's no loss causation as to those either, and that's because those statements were statements that were talking about the state of play at Freddie Mac in an earlier point in time, really in the context of having just reported their results for the second quarter of 2007.

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And there's nothing that Freddie Mac reported in the third quarter of 2007 press release that showed that any of those statements were false when they were made, or that showed that Freddie Mac is now disclosing something it had hidden before. The disclosures it made regarding its nontraditional mortgage products, regarding the performance of those products, regarding its buying, that was simply utterly consistent with the prior statements it had made on that subject for literally years. Not new.

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As far as -- so for that reason, there is no loss causation pled, on anything, anything. There is nothing in the November 20th press release that actually reveals the falsity of any of the challenged statements on any subject at all.

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Now, I want to also say, Freddie Mac subprime disclosures, the ones that Mr. Stock pointed to, what they actually say about the .1 percent is, "Also included in our credit guarantee portfolio are structured securities backed

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by non-agency mortgage-related securities where the underlying collateral was identified as being subprime by the original issuer." That's the actual disclosure.

So, and then the other disclosure, similarly, is referring to a certain amount of those securities that were "classified as subprime mortgage loans," that's what Freddie Mac is saying. It's saying, "We have a bright line." These are things that were literally identified as being subprime by the original issuer, classified as subprime.

Freddie Mac, for the guarantee portfolio, was not buying those loans, with the exception of this very small amount that was disclosed. In the same disclosure, on the same page, they talk about their retained portfolio. And they say, literally, "We are holding over $100 billion" -- that's a massive amount -- "of mortgage-backed securities backed by subprime loans, loans classified as subprime."

Now, Freddie Mac wasn't saying, "We don't have any loans that have low FICO scores or any loans with high LTV ratios." They talk about the E-Trade case. That company literally was saying, "We have all high FICO" -- I mean, "all high FICO, all low LTV loans," and then it comes out that's not true.

That's not Freddie Mac. Freddie Mac is disclosing all the hard data, and there is no allegation that any of it is false. So that's just -- that's not this case.

But the issue of no universal definition was, "We're not buying it for the guarantee portfolio if it's called subprime, and we're telling you the amount that we have that was called subprime, and we're really not in that business," and that really does explain why the performance of Freddie Mac's loans is so much better; and we have referred you to the FCIC report which confronted this exact same argument and said, "Grouping together these loans, the loans Freddie Mac held as compared" -- and the truly subprime loans that were issued by the investment banks that were backing the mortgage-backed securities that Freddie Mac was buying, that's misleading because of the fact that they are going -- they are performing very, very differently.

Freddie Mac's loans -- Freddie Mac and Fannie Mae loans with FICO scores 660 or below were defaulting at 6 percent, and the FCIC found that the same population of loans held by -- that were labeled subprime, that were FICO score 660 or below, defaulting at 28 percent. That's not a little bit different. That's not even double. That's over 400 percent different, which shows that the management of Freddie Mac was drawing valid distinctions between the loans that they were buying in their guarantee portfolio and loans that were literally labeled and classified as subprime loans.

Having said that, there was no universal

definition that the originators were using when they labeled loans subprime, which Freddie Mac disclosed.

And the SEC, for its part, in a complaint filed against Countrywide, refers to one definition, FICO score below 620; another definition of subprime, FICO score below 660. Two differing definitions.

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Now, under some definitions, if those are your definitions, I guess some of what Freddie Mac holds is subprime, except for this: Freddie Mac disclosed to the market 100 percent of the loans it held with FICO scores below 620, 4 percent at a particular point during this class period, and 100 percent of the loans it had with FICO scores below 660.

17:40:49

So if you're a FICO below 620 person, if that's your definition of subprime, have at it. Freddie Mac has 4 percent, if that's your definition. It's not Freddie Mac's definition, but if that's yours, 4 percent.

17:41:05

If you're a FICO 660 person, it looks like it's about 15 percent. If that's your definition of subprime, it isn't Freddie Mac's, but if that's yours, this is 100 percent of what we have that would fit within that definition.

17:41:19

That's why Judge Keenan came out the way he did, because those literally are the metrics that the street uses, that folks use when they assess the risks presented by

17:41:33

mortgage loans. And Freddie Mac disclosed all of that information. It wasn't hiding anything.

And so for all -- for all of those reasons, Your Honor, we believe that the motion to dismiss should be granted, and should be granted, in our view, with prejudice. It's the third amended complaint. We think that's enough. We think none of these folks did anything wrong. They didn't try to do anything wrong. They did their best to get it right, and I think they did get it right.

17:42:07 Thank you very much for your time, Your Honor.

THE COURT: Thank you, and thanks to all of you. I appreciate you all being so well prepared and trying, as best you could, to stay within your allotted timelines, and sometimes I encouraged you to go outside.

17:42:21 Consider the matter heard and submitted.

As you might have been able to tell, I've already begun to do some substantial work. I'll take the time to carefully review the rest of the record, meaning what we've augmented it by here today, and anything more I need before

17:42:35 issuing my decision. So while it might not come out immediately, it will come out relatively soon.

And with that, I bid you all good night and safe travels. It looks cloudy. I can't tell if we have any rain or weather, but do take care.

17:42:49 ALL: Thank you, Your Honor.

THE COURT: We're adjourned.

(Proceedings concluded at 5:42 p.m.)

C E R T I F I C A T E

I certify that the foregoing is a correct transcript from the record of proceedings in the above-entitled matter.

S/Mary L. Uphold — June 19, 2014
Mary L. Uphold, RDR, CRR — Date